Petition

81-735

No.

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In the Supreme Court of the United States

October Term, 1981

UNION PLANTERS NATIONAL BANK OF MEMPHIS,
Petitioner,

vs.

COMMERCIAL CREDIT BUSINESS LOANS, INC.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTIONS PRESENTED

1. Is a passive participation interest in a financing arrangement to supply capital necessary to finance business expansion, bearing a fixed rate of interest and issued by a finance company, a "security" within the meaning of the Securities Exchange Act of 1934?

2. Where a jury finds facts which support a judgment for a litigant on a valid legal theory, may judgment be denied by the court on the ground that the litigant failed to adequately "articulate" that theory?

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No.

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October Term, 1981

UNION PLANTERS NATIONAL BANK OF MEMPHIS,
Petitioner,

vs.

COMMERCIAL CREDIT BUSINESS LOANS, INC.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner, Union Planters National Bank of Memphis,[1] respectfully prays that a writ of certiorari issue to review the judgment and opinion entered by the United States Court of Appeals for the Sixth Circuit on May 18, 1981.

OPINIONS OF THE COURTS BELOW

The opinion below is reported at 651 F.2d 1174 (6th Cir. 1981), *reh. den.*, July 20, 1981, and is reproduced at App. 1-29 of the Appendix hereto. The opinion of the district court, not reported, is reproduced in the Appendix hereto at App. 30-36.

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1. Petitioner's parent is Union Planters Corporation. Petitioner has no non-wholly owned subsidiaries. Its affiliates are: Union Planters Bank of Nashville; Planters Life Insurance Company; Madison Loan & Thrift Company; and Union Planters Risk Management Company.

JURISDICTION

The judgment below (App. 37) was entered on May 18, 1981. Petitioner's timely request for rehearing was denied on July 20, 1981. App. 38. This Court has jurisdiction pursuant to 28 U.S.C. §1254(1).

STATUTE INVOLVED

United States Code, Title 15:

§78c. *Definitions and application*

(a) *Definitions.* When used in this title, unless the context otherwise requires—

* * *

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance, which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or renewal thereof the maturity of which is likewise limited.

STATEMENT OF THE CASE

The plaintiff in this suit (petitioner here), Union Planters National Bank of Memphis ("the Bank"), seeks rescission or damages from respondent, Commercial Credit Business Loans, Inc. ("CCBL"), for fraudulently inducing the Bank to purchase a $4 million participation in a credit package which financed the expansion of a retail furniture business. The complaint (A3-25)[2] alleged that the participation was a "security" within the meaning of the federal securities laws, and was sold in violation of those laws (15 U.S.C. §78j; 17 C.F.R. §240:10b-5) and Tennessee common law.

In 1971, respondent CCBL agreed to lend Donald Furniture Company ("DFC") up to $2 million, secured by retail accounts receivable, to finance the expansion of its business under new ownership. (Tr. 6-8.) CCBL promptly sold to the Bank a 50% participation interest in the financing package, after assuring the Bank that CCBL would exercise its sole authority to manage the financing by implementing proper financial controls at DFC and by keeping the Bank advised of the condition of the credit. (Tr. 9-10, 23-27.) In late 1972, after the Bank's $1 million was already at risk, sufficiently serious problems had developed to prompt one of CCBL's internal auditors to recommend that CCBL pull out. (A205, 208-209, 242, 248-249). Incredibly, CCBL not only withheld that information from the Bank (Tr. 46-47), but it later sent the Bank purported copies of its audit reports which were carefully edited to omit any such unfavorable information. (A324-332, 360-365, 370-391, 438-439; Tr. 851-860.)

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2. Record references are to the transcript (Tr.), the trial Exhibits (Exh.), or the Appendix (A) in the court below. Jurisdiction was based on 15 U.S.C. §78aa and 28 U.S.C. §1332.

By April of 1973, DFC owed CCBL $7.5 million, and the Bank $1 million. CCBL repeatedly assured the Bank that everything was going just fine. (Tr. 25, 60.) Yet, when DFC requested an additional $1.5 million, CCBL refused more financing unless the Bank could be persuaded to increase its participation. (A275-310.) However, CCBL gave the Bank a different story—that CCBL was going to increase the financing package to $10 million on its own, but was willing to let the Bank take half if it wished. (Tr. 49-51.) The Bank then purchased an additional $4 million participation interest in the DFC financing. (Tr. 51-52, 55-57.) The Bank immediately paid CCBL $3.2 million which, of course, reduced CCBL's exposure by that amount. (Tr. 57-58.)

CCBL's internal audit reports continued to reveal that the same old problems persisted at DFC, and CCBL continued to delete all unfavorable information from the edited versions which it sent to the Bank. (A329, 352-354, 362-365, 474-476.) In February of 1974 the Bank heard rumors that DFC was delinquent in paying trade creditors, and asked CCBL if it had similar information. (Exh. 35; Tr. 69-70.) CCBL's most recent audit report had included yet another internal recommendation that CCBL abandon DFC because (among other reasons) DFC was delinquent in paying trade creditors. (A372.) Typically, CCBL told the Bank it was not aware of any such problem (Tr. 71), and again followed up with an edited audit report which deleted all unfavorable information, including DFC's delinquency problem and such comments as: "This auditor strongly recommends that we try and get out of this account, immediately, before it is too late. . . ." (A376-378, 436-439; Exh. 49.)

By March of 1974 the Bank was sufficiently pessimistic about CCBL's candor and its participation interest to request that CCBL repurchase the participation. (A395-

396; Tr. 69-72.) CCBL declined on the ground that the participation agreement licensed it to manage the financing as it pleased.[3] (A398-399.) By September, DFC was in bankruptcy. The Bank promptly sued.

During the six-day jury trial as to liability only (CCBL offered no proof; Tr. 931), the trial judge ruled that the participation purchased by the Bank was a "security" under federal law. (Tr. 257.) The jury answered the three special interrogatories, as follows (A80):

> 1. Did the defendant violate the United States laws and regulations pertaining to the sale of securities by making an untrue statement of a material fact or by omitting to state a necessary material fact concerning the credit worthiness of the accounts receivable of Donald Furniture Co., Inc. in connection with the negotiation for and the execution of Amendment No. 1 to Participation Agreement dated July 11, 1973?
>
> X
> (Yes) _____ (No)
>
> 2. Did the defendant commit commercial fraud against the plaintiff under the law of Tennessee by making a negligent misrepresentation concerning the credit worthiness of the accounts receivable of Donald Furniture Co., Inc. in connection with the negotiation for and the execution of Amendment No. 1 to Participation Agreement dated July 11, 1973?
>
> X
> (Yes) _____ (No)
>
> If you answer the above question "Yes", please answer the following question in light of the instruc-

3. The trial court agreed that CCBL had "practically unlimited discretion" in managing the financing. (A121.)

tions pertaining to the cause of action under the Tennessee law.

Was the plaintiff guilty of contributory fault which proximately caused an injury to the plaintiff?

X	
(Yes)	(No)

The trial court entered judgment for the Bank as to liability under its federal claim, and for CCBL as to common law commercial fraud. (A117-118). (Without explanation the court also ordered "each party to bear its own costs"; A118.) CCBL moved for judgment notwithstanding the verdict or a new trial, and the Bank moved for judgment as to common law intentional fraud. Six months later the trial court set the judgment aside on the ground that the participation was not a "security" after all. The court also granted a conditional new trial based on a change of heart on the admissibility of certain evidence, and refused (without explanation) to enter judgment for common law intentional fraud. App. 30-36.

The Court of Appeals affirmed on the ground that a loan participation is not a "security," and on the ground that "the theory now articulated by the Bank"—that the jury necessarily found CCBL guilty of common law intentional fraud--was not properly articulated in the trial court. App. 1-29.

REASONS FOR GRANTING THE WRIT

1. The Decision Below Conflicts With A Decision Of The Third Circuit, Which This Court Has Agreed To Review, And With Decisions Of The Second Circuit, On What Constitutes A "Security" Within The Meaning Of The Securities Exchange Act Of 1934.

15 U.S.C. §78c(a)(10) defines "security" to include "any note . . . or any certificate of interest or participation in . . . any of the foregoing" (except notes of less than 9 months maturity[4]). (The Securities Act of 1933, at 15 U.S.C. §77b(1), contains a virtually identical definition.)

Applying a test purportedly derived from two opinions of this Court[5], the Sixth Circuit held that the Bank's participation was not a "security" because: the participation was not an "investment"; the Bank had no reasonable expectation of profit; and the "managerial or entrepreneurial efforts of others" were not involved. App. 14-17, 19-23. The opinion does not attempt to explain why interest is not a profit earned on an investment, as with any debenture, nor why DFC's entrepreneurial efforts were immaterial, in contrast to those of any debenture issuer.

The Second and Third Circuits disagree with the Sixth Circuit.[6] In *Exchange National Bank of Chicago v. Touche*,

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4. The opinion below concedes that the DFC financing had a maturity of 5 years. App. 16.

5. *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946); *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).

6. The Fifth and Seventh Circuits, however, agree with the Sixth Circuit. *United American Bank of Nashville v. Gunter*, 620 F.2d 1108, 1110 (5th Cir. 1980); *American Fletcher Mortgage Co. v. U.S. Steel Corp.*, 635 F.2d 1247, 1253-54 (7th Cir. 1980), *cert. denied*, ... U.S. ..... (1981).

Ross & Co., 544 F.2d 1126, 1137-38 (2d Cir. 1976), the court held that unsecured subordinated notes were "securities," on the ground that the statutory language expressly defines "security" to include every note with a maturity over nine months, and the securities law violator failed to demonstrate that the context required otherwise. *Accord*: *Zeller v. Bogue*, 476 F.2d 755 (2d Cir. 1973). Thus, within the Second Circuit, a participation interest in such a financing is also a "security." *Commercial Discount Corp. v. Lincoln First Commercial Corp.*, 445 F.Supp. 1263 (S.D.N.Y. 1978); *NBI Mortgage Investment Corp. v. Chemical Bank* [1976-1977 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶95,632 and [1977-1978 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶96,066 (S.D.N.Y. 1976 and 1977).

In *Weaver v. Marine Bank*, 637 F.2d 157 (3d Cir. 1980), *reh. denied* (1/26/81), amended (1/28/81), *cert. granted sub nom., Marine Bank v. Weaver* (No. 80-1562), ... U.S. ..... (1981), 49 Law Week 3893 (June 1, 1981), the Third Circuit reversed a summary judgment for defendant and held (one judge dissenting) that a certificate of deposit issued by a bank was at least presumptively a "security," stating:

> Since there is no general antifraud exemption for bank securities, and since when Marine Bank borrowed for more than nine months it issued what in all material respects is the functional equivalent of any other corporation's bond or note, we cannot on this record hold that a certificate of deposit evidencing its debt is not, like other long term bonds or notes, a security.
>
> * * *
>
> Given the special responsibility entrusted to them, the federal courts ought to interpret the 1934 Act

with a presumption of coverage of any transaction which Congress did not expressly exclude. *Id.*, 637 F.2d at 164, 165.

On June 1, 1981, this Court granted Marine Bank's petition for certiorari, which presents the question of whether an FDIC-insured certificate of deposit, bearing a fixed rate of interest and issued by a commercial bank, is a "security" as defined by the federal securities laws. *Marine Bank v. Weaver, supra.* That question raises the fundamental issue of the extent to which financial institutions, which regularly finance their own business operations and the business enterprises of others through non-equity interest-bearing instruments, enjoy the protection (and are subject to the penalties) of the federal securities laws.

The direct conflict, on an important question of federal law, between the decision of the Sixth Circuit in this case, and decisions of the Third and Second Circuits, justifies the grant of certiorari to review the judgment below.

2. The Decision Below Raises Significant And Recurring Problems Concerning The Scope Of Federal Jurisdiction Over Common Non-Equity Financing Arrangements.

The dissenting opinion in *Marine Bank, supra,* leads off with a statement all too true:

> It should come as no surprise that the panel is divided on the issues in this case because what constitutes a security under the 1933 and 1934 Acts is a matter which continues to trouble courts and commentators. 637 F.2d at 165.

The problem has produced, in addition to a conflict among the circuits, divisions even within circuits.[7] The problem has also produced equivalent frustration among commentators.[8] Rational business planning within the financial community is seriously hampered by uncertainty as to the applicability of the federal securities laws to non-equity financing arrangements. See Note, *Liabilities of Lead Banks in Syndicated Loans Under The Securities Acts*, 58 B.U.L. Rev. 45 (1978). Financial institutions and their lawyers are in urgent need of the assistance of this Court in understanding the extent to which widely used non-equity financing transactions are, or are not, subject to the federal securities laws.

The business of the courts is also hampered by the same uncertainty. The decision below raises significant and recurring problems concerning efforts to invoke federal jurisdiction to entertain actions based on securities violations. The nature and pervasiveness of this aspect of the problem is suggested by the Fifth Circuit's recent

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7. Compare, e.g., *Lehigh Valley Trust Co. v. Central National Bank of Jacksonville*, 409 F.2d 989 (5th Cir. 1969), with *United American Bank of Nashville v. Gunter, supra; Weaver v. Marine Bank, supra*, with *Provident National Bank v. Frankford Trust Co.*, 468 F.Supp. 448 (E.D. Pa. 1979); and *United States v. Carman*, 577 F.2d 556 (9th Cir. 1978) with *Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc.*, 583 F.2d 426 (9th Cir. 1978). *See*, also, *United California Bank v. THC Financial Corporation*, 557 F.2d 1351, 1357, n. 8 (9th Cir. 1977) ("While the underlying note may not be a security, the participation interest may fall within the definition of a security.")

8. Compare, e.g.: Sonnenschein, *Federal Securities Law Coverage of Note Transactions: The Antifraud Provisions*, 35 Bus. Lawyer 1567 (1980); Faust, *What Is A Security?*, 33 Sec. Reg.L.J. 219 (1975); FitzGibbon, *What Is A Security?—A Redefinition Based On Eligibility To Participate In The Financial Markets*, 64 Minn.L.Rev. 893 (1980). Comment, *Commercial Notes and Definition of "Security" Under The Securities Exchange Act of 1934: A Note Is A Note Is A Note?*, 52 Neb.L. Rev. 478 (1973); and Note, *Bank Loan Participations As Securities: Notes, Investment Contracts, and the Commercial/Investment Dichotomy*, 15 Duquesne L.Rev. 261 (1976).

difficulty with *Williamson v. Tucker*, 632 F.2d 579 (5th Cir. 1980), *opinion withdrawn*, 645 F.2d 404 (5th Cir. 1981), *cert. pending* (No. 81-285). The panel first published a 26 page opinion and then (on rehearing) withdrew it and published a 24 page opinion, in reversing a dismissal for lack of subject matter jurisdiction which turned on the federal definition of "security." The latter opinion noted:

> [I]n the four recent instances in which we have considered whether a note was a security within the meaning of the federal securities acts [citations omitted] the issue was raised in the form of a motion to dismiss for lack of subject matter jurisdiction. Although it does not appear that the appropriateness of such a motion was challenged, we did not find in any of these cases that it was improper. *Id.*, 645 F.2d at 429.

Greater precision in being able to determine whether a financing arrangement is or is not a "security" is an essential prerequisite to a rational delineation of the scope of federal subject matter jurisdiction over fraud cases involving interest-bearing non-equity finincing arrangements.

This Court will address these problems this term, with respect to bank certificates of deposit, in deciding *Marine Bank v. Weaver, supra.* The importance of the problem, evidenced by the grant of certiorari in that case, justifies the grant of certiorari in this case to address the identical problem in the context of an interest bearing participation in a non-equity financing arrangement.

3. The Decision Below Is In Conflict With A Recent Decision Of The Fifth Circuit, And With Decisions Of Other Circuits, As To Whether A Trial Court May Disregard A Jury's Factual Findings And Withhold Judgment Because A Party Failed To Adequately Articulate The Proper Legal Theory.

The Sixth Circuit approved the trial court's refusal to "enter judgment for the Bank on intentional fraud under Tennessee law because the Bank never asserted a claim based on this cause of action," noting that the pretrial order "does not embrace the theory now articulated by the Bank." App. 27.[9]

Almost contemporaneously with the opinion below, the Fifth Circuit issued an opinion squarely in conflict with it. *Life Insurance Co. of Virginia v. Murray Investment Co.*, 646 F.2d 224 (5th Cir. 1981), *reh. granted in part* (attorneys fees issue) and otherwise *denied*, 651 F.2d 1090 (5th Cir. 1981), is a suit by the purchaser of a real estate note against the seller for damages based on fraud and breach of contract. Statutory securities acts claims were dismissed prior to trial (and not presented on appeal.) The purchaser based its state law fraud claim entirely on a violation of a Texas statute, Tex. Bus. and Comm. Code Ann. §27.01. The jury found both fraud and a breach of contract, but the trial court held that the statute was not applicable as a matter of law and refused to enter judgment

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9. Curiously, the opinion seeks to buttress the result by holding that "an issue not presented to the trial court cannot be raised for the first time on appeal." App. 28. The opinion accurately noted much earlier that "the Bank moved [in the trial court] to alter or amend the judgment on the Tennessee common law count", a motion which squarely raised the precise issue. App. 4, 24.

The opinion also disregards the record (A3-25) in asserting that "the complaint fails to hint at an assertion of a common law intentional fraud claim." App. 27.

for damages based on common law fraud. The Fifth Circuit agreed that the statute was inapplicable, but reversed nevertheless, stating:

> [W]hile [plaintiff's] original or subsequent complaints do not specifically set forth a claim for relief entitled "common law fraud," the Complaints clearly plead facts which, if proven, would constitute common law fraud and such facts were incorporated by reference within [plaintiff's] Breach of Contract claim for relief. As previously mentioned, the District Court refused [plaintiff's] request to amend to seek consequential damages based upon a common law fraud theory because the defendants lacked adequate discovery concerning such measure of damages. However, the Court did not remove the factual basis of fraud which had been pled and upon which the Breach of Contract cause of action was based. We find that [plaintiff's] pleadings were sufficient to raise the fraud as a basis for its breach of contract cause of action.
>
> [I]t is true that the District Court expressed doubt as to the applicability of Section 27.01 as a cause of action. In its Memorandum Opinion, dated April 5, 1979, the Court specifically held that if Section 27.01 were found inapplicable, [plaintiff] would be "left with a straight breach of contract claim, and exemplary damages would not be recoverable. . ." We have held (see n. 2) that the District Court was correct regarding the inapplicability of Section 27.01. However, the inapplicability of Section 27.01 as a legal remedy in no way negates the fact issues submitted to the jury regarding fraud. Through several special issues the jury found each and every factual element of fraud against both defendants and also found that each knew that

> their representations were false at the time they were made. We find that the District Court erred in disregarding the jury's findings of fraud as a basis for the tortious conduct necessary for exemplary damages and, under either the tortious breach of contract theory or upon the fraud theory, hold that [plaintiff] should have been awarded the exemplary damages as found by the jury. *Id.*, 646 F.2d at 229.

That holding accords with the following holdings by other circuits: *Brown v. Ward*, 438 F.2d 1285 (4th Cir. 1970); *Hamill v. Maryland Cas. Co.*, 209 F.2d 338 (10th Cir. 1954); *Janke Construction Co. v. Vulcan Materials Co.*, 527 F.2d 772 (7th Cir. 1976).

The notion which produced the decision below, that a court may disregard factual findings which support relief under a valid legal theory because the party otherwise entitled to the relief failed to adequately "articulate" that theory, is a throwback to theories of code pleading which the Federal Rules of Civil Procedure were expressly implemented to eliminate. See (Judge Charles E.) Clark, *Code Pleading* at p. 259 (2d ed. 1947), and (Judge Charles E.) Clark, *Cases on Pleading and Procedure* (2d ed. 1940).

The conflict between the decision below and those of other circuits on this important question of federal procedure justifies the grant of certiorari to review the judgment below.[10]

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10. Counsel is informed that a petition for certiorari seeking review of the Fifth Circuit's decision in *Life Insurance Co. of Virginia v. Murray Investment Co., supra*, presenting the same issue as the second issue presented here, is to be filed in this Court within the next two weeks.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Sixth Circuit.

Respectfully submitted,

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APPENDIX

No. 79-1191

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

UNION PLANTERS NATIONAL BANK OF MEMPHIS,
Plaintiff-Appellant,

v.

COMMERCIAL CREDIT BUSINESS LOANS, INC.,
Defendant-Appellee.

Appeal from the United States District Court
for the Western District of Tennessee.

Decided and Filed May 18, 1981.

Before: ENGEL and KEITH, Circuit Judges; CELEBREZZE, Senior Circuit Judge.

CELEBREZZE, Senior Circuit Judge. The principal issue in this case is whether a loan participation agreement executed between two financial institutions constitutes a "security" within the meaning of the Securities Exchange Act of 1934.

I.

Plaintiff, Union Planters National Bank of Memphis (the Bank) appeals from a judgment notwithstanding the verdict and the conditional grant of a new trial entered in

favor of the defendant, Commercial Credit Business Loans, Inc.[1] (CCBL). In its complaint the Bank sought recission or damages from CCBL for allegedly fraudulent representations made by CCBL's agents which induced the Bank to purchase a participation in a line of credit extended by CCBL to Donald Furniture Co. (Donalds). Specifically, the Bank alleged that the loan participation agreement constituted a "security" under federal law and that CCBL made false statements of material fact, omitted to state material facts necessary to make the statements not misleading, and employed a device, scheme or artifice which operated as a fraud upon the Bank, all in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. sections 78j (1970),[2] Rule 10b-5 of the Securities

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1. When a trial court grants judgment notwithstanding the verdict and grants a new trial in the alternative, the judgment notwithstanding the verdict is final and appealable, allowing us to review both rulings. *See* Fed.R.Civ.Pro. 50(c)(1).

> This departure from the normal rule that a motion granting a new trial is interlocutory and non-appealable is justified by the obvious fact that the principal judgment is clearly final; the new trial grant will never be effective unless the judgment is overthrown. Since the principal judgment is appealable, it would be wasteful to hold that the court of appeals cannot review all that happened below in the event that it holds the grant of judgment notwithstanding the verdict to have been erroneous.

9 MOORE'S FEDERAL PRACTICE Sec. 110.08[3], at 122 (2d ed. 1948). Accordingly, we have jurisdiction to consider both the judgment notwithstanding the verdict and the conditional grant of a new trial. *See e.g. Bazile v. Bisso Marine Co., Inc.*, 606 F.2d 101, 104 (5th Cir. 1979), *cert. denied*, 101 S.Ct. 94 (1980).

2. 15 U.S.C. Sec. 78j provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails.
>
> (b) To use or employ in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

and Exchange Commission, 17 C.F.R. section 240.10b-5,[3] and principles of Tennessee common law.

The district court initially held that the loan participation agreement was a security and allowed the Bank to present evidence on its federal law claims.[4] After six days of trial CCBL declined to offer any proof and the case was submitted to the jury together with three special verdicts.[5]

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3. 17 C.F.R. Sec. 240.10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange.

(a) To employ any device, scheme, or artifice to defraud.

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

4. Prior to trial the district court granted CCBL's motion to dismiss the Bank's claim for rescission, holding that the Bank had waived its right to rescission by continuing to accept payments from CCBL under the terms of the agreement.

In response to other CCBL motions, the court severed the issues of liability and damages, and ruled that simple negligence does not violate the federal securities laws. *See e.g., Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 428-31 (6th Cir.), *cert. denied sub nom., Adams v. Peat, Marwick, Mitchell & Co.*, 101 S.Ct. 795 (1980).

5. 1. Did the defendant violate the United States laws and regulations pertaining to the sale of securities by making an untrue statement of a material fact or by omitting to state a necessary material fact concerning the credit-worthiness of the accounts receivable of Donald Furniture Co., Inc. in connection with the negotiation for and the execution of Amendment No. 1 to Participation Agreement dated July 11, 1973?

Yes ..... No .....

2. Did the defendant commit commercial fraud against the plaintiff under the law of Tennessee by making a negligent misrepresentation concerning the credit-worthiness of the accounts receivable of Donald Furniture Co., Inc. in connection with the

(Continued on following page)

The jury found in favor of the Bank on the federal securities count and the Tennessee negligent misrepresentation fraud claim, but also found the Bank guilty of contributory fault which proximately caused its injury. Judgment on the federal law liability issue was entered in favor of the Bank and a judgment in favor of CCBL was entered on the common law fraud claim because contributory negligence is a defense to the tort of negligent fraud. CCBL then moved for a judgment notwithstanding the verdict or for a new trial, and the Bank moved to alter or amend the judgment on the Tennessee common law count. Subsequently, the trial judge granted CCBL's motion for JNOV on the grounds that he had changed his mind and was now ruling that the participation purchased by the Bank was not a security. A conditional new trial was also granted on that issue because of what the trial judge felt were substantial errors in the formulation of the special verdicts and in the admission of certain testimony. We affirm the judgments entered for CCBL on the federal and state law claims.

II.

Donald Furniture Company was a retail seller of home furnishings. Its relationship with the Bank dated to 1946, when the Bank began lending money to Donalds. Those loans were secured by the company's accounts receivable.

Footnote continued—

negotiation for and the execution of Amendment No. 1 to Participation Agreement dated July 11, 1973?

Yes ..... No .....

If you answer the above question "Yes", please answer the following question in the light of the instructions pertaining to the cause of action under the Tennessee law.

Was the plaintiff guilty of contributory fault which proximately caused an injury to the plaintiff?

Yes ..... No .....

In 1968, Donalds was sold by its founders and owners, the Pelts family, to Gulf Life Insurance Company. In 1971, Donalds had an outstanding loan of $700,000.00 from the Bank, secured by a take-out commitment from Gulf Enterprises, the holding company for Gulf Life. Gulf Life eventually sold the Donald chain to Tenn-Ark Furniture World Corp. in 1972.

During the years 1946-1971, Donalds had experienced substantial growth and in 1971 sought new financing in the amount of $2 million. On October 21, 1971 two Donald's officials approached Mr. C. W. Irvine, the Union Planters officer in charge of the Donald's account, regarding the possibility of the Bank participating with a finance company (CCBL) in a loan to Donalds. The Bank's participation was solicited because the Bank's interest charges were lower than CCBL's. Shortly thereafter, Irvine was approached by CCBL's representative, Oscar Edwards, to discuss further the loan participation.

When prospects for consummation of the participation appeared good, Donalds and CCBL executed a Revolving Loan Agreement on November 26, 1971. The Revolving Loan Agreement provided that Donald would receive continuous cash advances from CCBL based upon the value of all Donald's existing and future accounts receivable; the accounts receivable would also serve as collateral to secure the loan.

On December 17, 1971, the Bank and CCBL executed a Participation Agreement which provided that the Bank would participate to the extent of providing 50 percent of the first two million dollars advanced to Donalds. The Bank, in turn, received rights in Donald's accounts receivable commensurate with its 50 percent share of the loan. The collateral security was defined as any and all of

Donald's accounts receivable. The value of that collateral was to be determined solely by CCBL, which was given, in the words of the trial judge, "practically unlimited discretion" in its role as lead bank administering the loan. The extent of CCBL's primacy in managing the loan to Donalds is reflected in Paragraph 7 of the Participation Agreement:

> 7. Commercial Credit may in its sole discretion approve or decline to approve the credit risk on and acceptability of Collateral; take, release, substitute or refuse Collateral or other security; give or withhold waivers, consents, extensions, adjustments, compositions or compromises; amend or refuse to amend the Financing Agreement or other agreements relating thereto; exercise or refrain from exercising rights, or take or refrain from taking action with respect to Advances, Collateral, other security or with respect to the Financing Agreement, or in any other way in making, handling, collecting, realizing upon, or enforcing repayment of Advances or Collateral or other security or the Financing Agreement of guaranties; and, without limitation, Commercial Credit makes no representations and assumes no responsibility with respect to Collateral, the Financing Agreement or other papers relating thereto, or to their value, validity or enforceability, or the correctness of any papers, statements or certificates made by the Customer.

The Participation Agreement also provided that the Bank would have access, upon request, to all CCBL records with regard to the loan; CCBL was obligated, however, to deliver to the Bank periodic statements reflecting the status of Donald's account with CCBL.

By March, 1972, Donalds had received the total two million dollars — one million each from the Bank and CCBL. Donald's need for cash infusion, however, was not

satisfied by that loan alone, as CCBL continued lending money to Donalds pursuant to the separate Revolving Loan Agreement it had executed with Donalds. During the course of the next twelve months, CCBL advanced more than five million dollars to Donalds.

In supervising the progress of the loan, audits of Donald's financial records were conducted by a sister company of CCBL, Commercial Credit Management Corp. The primary purpose of these audits was to determine whether there was a proper flow of funds pursuant to the loan. If the audits revealed an unsatisfactory state of affairs, the results would be followed up by the CCBL official in charge of the loan, Frank Mederios.

The audit of August 17, 1972 turned up serious problems with respect to Donald's control over its accounts receivable — the collateral for the loan. Specifically, the auditor found that Donald's had "no control" over those accounts; that Donalds billed for unshipped merchandise making it impossible to establish a dollar value for those receivables; that the company's system of extending and refinancing receivables was not protected by CCBL's audit requirements; and that the company's reporting delays were unreasonable. In order to correct these deficiencies the auditor recommended the implementation of certain procedures to bring about some degree of control over the accounts receivable should CCBL choose to disregard his advice to discontinue the account. Neither the auditor's problematic diagnosis nor his recommendations were contained in the report given the Bank.

Donald's problems had not improved by the next audit on December 16, 1972. The same auditor again advised against continuing the account, observing that "Quantitatively, we do not know what we have . . . . Qualitatively, we are also unaware of our position." The audit report

which CCBL forwarded to the Bank was an edited version which did not contain the adverse recommendation made by the auditor.

Several months later it appeared that Donald's situation was improving. The audit report of April 27, 1973, indicated that Donalds had made substantial progress in clearing up the problems associated with its control of the accounts receivable. Unlike the two previous reports, the April audit, authored by a different auditor, recommended that CCBL retain its account with Donalds. And despite any accounting problems, Donalds was apparently a healthy company. Both the Bank and CCBL received copies of the favorable financial statement for the year ending December 31, 1972 prepared by Donald's accountants, Haskins & Sells and dated March 2, 1973.

By April, 1973, Donalds was indebted to CCBL for 7.5 million dollars, in addition to the one million dollars it owed the Bank. At that time CCBL decided to increase the amount of its loan to Donalds by $750,000, raising the debt to $8,250,000. Donalds, however, anticipated a future need for 10 million dollars in credit.

On April 10, 1973, representatives from Donalds met with the Bank's executive, Irvine, and proposed that the Bank increase its participation with CCBL from $1,000,000 to $5,000,000, or 50% of $10,000,000 total, available on a five-year revolving term basis. In the estimate of the Donald's officials, that amount of financing would satisfy their needs for at least two years during which time they expected to raise additional funds by a public stock offering. On April 13, 1973, the Bank advised Donalds that it was agreeable to a 50% participation in the $10,000,000 line of credit at the prime rate plus two points. Consequently, the Loan Participation Agreement was amended on July 11, 1973 to provide for a $10 million line of credit in which

the Bank would have a 50% participation.[6] The Bank was therefore required to pay CCBL $3.2 million, reducing CCBL's exposure by that amount, and bringing the loan balance to $8.4 million. By October 22, 1973 the loan balance had reached the full $10 million.

In December, 1973, Irvine learned that CCBL unilaterally intended to increase Donald's financing to $12.5 million. Irvine contacted Mederios at CCBL to ask about the financing increase and to request copies of any recent audit reports. In a letter to Irvine dated December 28, 1973, Mederios wrote that he would have the final draft of the amendment increasing the line of the loan in about one week, and that CCBL's posture at that time was one of holding off consideration of any further expansion in 1974. In fact, however, CCBL and Donalds had executed the amendment to the Secured Term Loan Agreement over one month beforehand, on November 9, 1973. That amendment, while increasing the credit line, also extended the payout period of the loan. CCBL also forwarded an edited version of an audit of September 12, 1973, which omitted the adverse comments made by the auditor.

In February, 1974, Irvine and the Bank learned that Donalds was delinquent in paying some of its creditors. Irvine forwarded to CCBL a memo from the Bank's credit department, inquiring whether CCBL had similar information. According to Irvine's testimony, Mederios informed him that several checks had been made which did not show any serious trade slowness. A February 11, 1974,

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6. It was the circumstances preceding this amendment increasing the Bank's participation to 50% that the alleged fraud (misrepresentations regarding the creditworthiness of Donald's accounts receivable) occurred; the Bank does not contend that there was fraud involved in the execution of the original Participation Agreement. In light of our disposition of the case, we need not decide whether the amendment of the Participation Agreement is "in connection with the purchase or sale of any security."

CCBL audit report, however, recommended that CCBL abandon Donalds because the company was delinquent in paying trade creditors. The Bank received a sanitized version of that audit in May, 1974.

In early 1974 Donalds experienced cash flow difficulty. On March 20, 1974, the Bank requested that CCBL repurchase its share of the loan. At that time Irvine believed that the Bank could so terminate its participation at any time. The Agreement, however, only permitted the Bank to decline to participate in future advances; there was no provision permitting it to rescind its involvement with regard to funds already advanced. Citing these provisions, CCBL declined to repurchase the Bank's share of the loan.

Donald's financial health worsened rapidly. By June, Donalds was in default by $1.7 million and delinquencies in the accounts receivable were rising. In September, 1974, Donalds was placed in bankruptcy. The Trustee turned over the accounts receivable to CCBL, which began to collect them, remitting to the Bank its share of the liquidation proceeds. When CCBL continued to refuse to repurchase the Bank's share, the Bank filed this action in February, 1975.

III.

The threshold question in any action brought pursuant to the Securities Acts is whether a security exists. The search for the definition of a "security" must necessarily commence with the language of the statute. *Rubin v. United States*, ... U.S. ..... (1981); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring).

Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. Sec. 78c(a)(10) provides:

(a) When used in this chapter, unless the context otherwise requires—

(10) The term 'security' means any note, stock, treasury stock, bond, debenture, *certificate of interest or participation* in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a 'security'; or *any certificate of interest or participation in,* temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grade, or any renewal thereof the maturity of which is likewise limited. (Emphasis supplied.)

The Securities Act of 1933, 15 U.S.C. Sec. 77b(1) provides a similar definition of security, a definition which the Supreme Court has termed "virtually identical" to that of the Securities Exchange Act of 1934. *Tcherepnin v. Knight,* 389 U.S. 332, 335-336, 88 S. Ct. 548, 552-553, 19 L.Ed.2d 564 (1967). While both Acts contain admittedly broad definitions, not every commercial transaction is within their ambit. *See Curran v. Merrill Lynch, Pierce, Fenner and Smith,* 622 F.2d 216, 222 (6th Cir. 1980), *cert. granted* ..... U.S. ..... (1981). The literal inclusion of participation within the statutory definition of "security" is not dispositive of the question, however, in view of the provision in both Acts that the definitions apply "unless the context

otherwise requires."[7] In interpreting the Securities Acts, the rules of statutory construction have been subordinated to the doctrine that courts will construe the provisions of a statute in a matter consistent with its dominent purpose and will carry out the generally expressed legislative policy by reading the text in light of the context.[8] *See SEC v. National Securities, Inc.*, 393 U.S. 453, 466 (1969). *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350-51 (1943). In fact, in determining the scope of the term "security," the Supreme Court has disregarded form in favor of substance and counselled that application of the federal securities statutes turns on the "economic realities" underlying a transaction. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 848 (1975); *Tcherepnin v. Knight, supra* at

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7. The antiliteralist approach of the Supreme Court in *Forman* and antecedent securities cases is at odds with *Lehigh Valley Trust Co. v. Central National Bank of Jacksonville*, 409 F.2d 989 (5th Cir. 1969), upon which the Bank relies. In *Lehigh Valley* the Fifth Circuit read the statute literally in holding that a participation agreement was a security within the statutes and Rule 10b-5. *Id.* at 992. That literal approach is now discredited even in that circuit. *See McClure v. First National Bank of Lubbock*, 497 F.2d 490, 493-94 (5th Cir. 1974); *Bellah v. First National Bank of Hereford*, 495 F.2d 1109, 1111-14 (5th Cir. 1974).

A new literalism emerged, however, in *Exchange National Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976), where the court found the *Forman* test to be of "dubious value" in the context of deciding whether unsecured subordinated notes purchased by the Exchange National Bank were securities. The best recourse, the court believed, was to follow the language of the Acts, which includes every note with a maturity period over nine months, unless the party asserting that there is no security demonstrates that the context requires otherwise. *Id.* at 1137-38.

8. The Congressional purpose was capsulized by the Supreme Court in *Forman*, 421 U.S. at 849:

> The primary purpose of the Securities Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interests of investors.

336. In focusing on the economic realities to distinguish securities transactions from commercial dealings, the Court has used a test which, in "shorthand form":

> . . . embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is (1) the presence of an investment (2) in a common venture (3) premised on a reasonable expectation of profits (4) to be derived from the entrepreneurial or managerial efforts of others.

Forman, supra at 852.[9]

In applying the *Howey-Forman* criteria in the context of commercial loan participations, the courts have divided on whether a security exists. A few courts have held that a loan participation is a security. *See Commercial Discount Corp. v. Lincoln First Commercial Corp.*, 445 F. Supp. 1263 (S.D. N.Y. 1978); *NBI Mortgage Investment Corp. v. Chemical Bank*, (1976) Fed. Sec. L. Rep. (CCH) Par. 95, 632 (S.D. N.Y. 1976) and (1977) Fed. Sec. L. Rep. (CCH) Par. 96,066 (S.D. N.Y. 1977) A majority of the courts, however, have reached the opposite conclusion. *See American Fletcher Mort. Co. v. U.S. Steel*, 635 F.2d 1247, 1253-54 (7th Cir. 1980) *cert. denied*, ... U.S. ..... (1981); *United Bank of Nashville v. Gunter*, 620 F.2d 1108, 1110 (5th Cir. 1980);

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9. The genesis of this test is *SEC v. W. J. Howey Co.*, 328 U.S. 293, 301 (1946) and the only deviation from the *Howey* language is the omission of the prefatory term "solely" from the phrase "profits to come solely from the efforts of others." *Id.* at 301. Several courts have interpreted the "solely" requirement to mean only that the "crucial" profit making efforts be made by a third party. *Commander's Palace Park v. Girard & Pastel Corp.*, 572 F.2d 1084 (5th Cir. 1978); *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 479 (5th Cir. 1974); *SEC v. Glenn W. Turner Enterprises*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). The Supreme Court declined to adopt or reject the modification in *Forman*, 421 U.S. at 852, n.16, although the shift in semantics in the fourth phase from *Howey* to *Forman* is the Court's own. *See also Williamson v. Tucker*, 632 F.2d 579, 593-94 (5th Cir. 1980).

Manchester Bank v. Conn. Bank & Trust Co., 497 F. Supp. 1304, 1309-13 (D. N.H. 1980); *Provident National Bank v. Frankford Trust Co.*, 468 F. Supp. 448, 452-55 (E.D. Pa. 1979); *FBS Financial, Inc. v. Clevetrust Realty Investors*, (1978) Fed. Sec. L. Rep. (CCH) Par. 96,341 (N.D. Ohio 1977). We agree with the wisdom of this position, and for the reasons that follow conclude that the loan participation purchased by the Bank does not constitute a security.

PRESENCE OF AN INVESTMENT

In passing on the first phase of the *Howey-Forman* test, several courts have recognized the dilemma inherent in distinguishing between investment and commercial transactions:

> In one sense, every lender of money is an investor since he places his money at risk in anticipation of profit in the form of interest. Also, in a broad sense every investor lends his money to a borrower who uses it for a price and is expected to return it one day.

FBS Financial, supra, at 93,156 *quoting* C.N.S. *Enterprises, Inc. v. G & G Enterprises, Inc.*, 508 F.2d 1354, 1359 (7th Cir.), *cert. denied*, 423 U.S. 825 (1975).

To assist in isolating the investment transactions which the Securities Acts were intended to cover, the courts have developed several modes of analysis, the most popular of which is the "risk capital" test enunciated in *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252, 1257 (9th Cir. 1976).[10]

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10. For a critique of the shortcomings of this test, see Note, *Bank Loan Participations as Securities: Notes, Investment Contracts, and the Commercial/Investment Dictionary*, 15 Duquesne L. Rev. 261, 286-91 (1976-77). Although, the Second Circuit criticized this test in *Exchange National Bank, supra*, it is evident that arguing from the phrase "unless the context otherwise re-

(Continued on following page)

See also United Cal. Bank v. THC Financial Corp., 557 F.2d 1351, 1358 (9th Cir. 1977). The "risk capital" test focuses on six criteria: 1) time; 2) collateral; 3 form of the obligation; 4) circumstances of issuance; 5) relationship between amount borrowed and size of borrower's business; and 6) intended use of the funds. Since the loan agreement in *Great Western* was carefully tailored to the bank's requirements, placing extensive restrictions on the use of the loan proceeds and the conduct of the financial operation, the court held that the loan was not "risk capital" but was simply a commercial loan subject to the hazards normally incident to such transactions. A concurring opinion focused on the absence of any indication in the legislative history of the securities laws that Congress intended to include commercial financing within their protection. Noting that commercial bank lending is unrelated to the abuses associated with investing that Congress intended to eliminate through the Exchange Act, the concurrence concluded that the federal securities statutes were inapposite to notes received by a bank in an exercise of its lending function. 532 F.2d at 1260-1262. *See also Movielab, Inc. v. Berkey Photo, Inc.*, 321 F. Supp. 806, 808-09 (S.D. N.Y. 1970), *aff'd*, 452 F.2d 662 (2d Cir. 1971).

Measuring the transaction in the present case against the risk capital criteria, we conclude that the participation agreement does not evidence an "investment" within the

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Footnote continued—

quires" invites consideration of many of the same factors present in the "risk capital" analysis. *See Exchange National Bank*, 544 F.2d at 1138-39. Were we not constrained by the *Forman* framework, we might be tempted to examine a fresh approach to the subject. *See e.g.* FitzGibbon, *What is a Security? — A Redefinition Based on Eligibility to Participate in the Financial Markets*, 64 Minn. L. Rev. 893 (1980) (proposing as the definition of security "a financial instrument eligible to participate in a public market" based upon the history of the securities legislation and mechanics of the markets). *Id.* at 919.

meaning of *Howey-Forman*. Indeed, the Bank's own nomenclature reveals that it did not consider its participation as an investment. On that score, the name assigned to the transaction by the parties, although not dispositive, is relevant in determining security status. *Forman*, 421 U.S. at 850. Throughout the transaction it is clear that the Bank regarded its participation as a loan, rather than an investment. The document which Irvine submitted to the Bank's Executive Committee reporting the Participation Agreement was entitled "Line of Credit Approved or Disapproved." Sundry other Bank memos confirm this characterization, referring to the "lending" involved and the Bank's prior lending to Donalds as "direct," implying that the loan participation was merely an "indirect" loan of the same nature. There is no indication in the record that the Bank distinguishes between participatory and direct loans, and the Bank's participation with CCBL in the extension of credit to Donalds was apparently approved by the same officials who normally pass on direct loans. William Acker, the Bank's expert concerning industry standards in connection with loan participations, referred many times in his testimony to CCBL as the "primary lender" in the loan. These factors confirm the parties perception of the participation as nothing more than a routine commercial loan.

The *Great Western* test first examines the time frame in which the funds are retained by the borrower; the longer the money is held, the more probable it becomes than an investment is involved. *Great Western*, *supra*, at 1257-58. Here, the Secured Term Loan Agreement provided that Donalds would commence repayment of the loan amounts almost immediately, and would have the entire balance paid off by November 30, 1978. More importantly, the full amount of any advances were collateralized by Donalds'

accounts receivable. The loan apparently had sufficient collateral when executed, and the Bank never sought to investigate or appraise the adequacy of the accounts receivable. The existence of collateral is strongly suggestive of a commercial loan. *See FBS, supra* at 93,156.

The additional factors also counsel against finding an "investment." There was no public offering and there is no indication that the participation interest was "procured for speculation or investment." *See McClure v. First National Bank*, 497 F.2d 490, 493 (5th Cir. 1974), *cert. denied*, 420 U.S. 930 (1975); *Lino v. City Investing Co.*, 487 F.2d 689, 694-95 (3rd Cir. 1973). The Bank was well aware that the loan proceeds were to be used to finance Donald's current operations instead of serving as risk capital to obtain new productive assets. Although the Bank insists that because of CCBL's control over the loan, it (the Bank) was no more than a passive investor, we feel that the *Great Western* factors militate against finding an investment here.

COMMON VENTURE

The second prong of the *Howey-Forman* test looks for the existence of a "common venture." While the trial judge characterized the loan syndication as a "joint venture," the Bank urges that the facts here support a finding of a common venture, without offering any insight as to the distinction between the two terms. In considering whether a given relationship between parties to a transaction satisfies the common venture element for a security, the courts have identified two types of alliances: vertical and horizontal. *See* Note, *Liabilities of Lead Banks in Syndicated Loans under the Securities Acts*. 58 B.U.L. Rev. 45, 56-58 (1978). A common enterprise involving vertical commonality is one in which the fortunes of the investor

are interwoven with and dependent upon the efforts and success of those seeking the investment of third parties. *See SEC v. Continental Commodities Corp.*, 497 F.2d 516, 521-22 (5th Cir. 1974); *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 n.7 (9th Cir. 1973). It requires only that the investor and promoter be involved in some common venture without requiring the involvement of other investors. *Bradt v. Bache & Co., Inc.*, 595 F.2d 459, 461 (9th Cir. 1980). A vertical relationship is best illustrated by a one-on-one arrangement between a lender and a customer. A horizontal common enterprise, on the other hand, requires a heightened degree of affiliation. Horizontal commonality ties the fortunes of each investor in a pool of investors to the success of the overall venture. *See Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274, 278 (7th Cir.) *cert. denied*, 409 U.S. 887 (1972).[11] In fact, a finding of horizontal commonality requires a sharing or pooling of funds. *See Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 101 (7th Cir. 1977).

This circuit selected its approach in *Curran v. Merrill Lynch, Pierce, Fenner and Smith*, 622 F.2d 216 (6th Cir. 1980), *cert. granted*, ... U.S. ..... (1981). In deciding that a discretionary trading account was not a security, Judge Engel noted that a requirement of horizontal commonality best comported with the language of *Howey*, because in a common enterprise all investors must share a common fortune. *Id.* at 222. The relationship in *Curran* was entered into solely between the plaintiff as an investor

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11. In *Milnarik*, unrelated discretionary commodities accounts were all managed by the same commodities broker. Since the accounts were not connected and were not managed similarly, the success or failure of one account had no effect on the status of the other accounts. Each investor received profits from the sale of commodities in his own account, rather than a share of the aggregate profits that the diverse accounts generated collectively. 457 F.2d at 276-77.

and Merrill Lynch as broker. To find a common enterprise in that relationship—where a principal has entrusted funds to an agent—the court noted, would effectively excise that requirement from the *Howey-Forman* test.

Under the facts of the present case we have little difficulty recognizing a common enterprise. The fortunes of the Bank and CCBL as lenders in this transaction were inextricably intertwined. The loan shares of the Bank and CCBL were not unitary in nature; the success or failure of each was not without regard to the other. The profits or losses flowed uniformly to each. As a result, when Donalds entered bankruptcy, the proceeds from collection of the accounts receivable were channelled pro rata, on a 50-50 basis, to the Bank and CCBL. On the whole, then, the Bank and CCBL were engaged in a common venture to loan money to Donalds.

REASONABLE EXPECTATION OF PROFITS

The Participation Agreement provided that the Bank would be repaid the amounts of principal advanced plus a fixed rate of interest. The Bank argues that "the fact that the profits of the Bank reasonably expected to receive from its investment were interest earnings does not in any way diminish the investment nature of the contract." To support this contention, the Bank cites *MacKethan v. Peat, Marwick, Mitchell & Co.*, 1978 Fed. Sec. L. Rep. (CCH) Par. 96,342 (E.D. Va. 1977), for the proposition that the Securities Acts encompass debt as well as equity instruments. While it is true that the Securities Acts may regulate certain debt instruments which offer fixed rates of return, *see El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224, 1229 (9th Cir.), *cert. denied*, 419 U.S. 900 (1974), that generalized observation does not establish that the interest

earnings realized by the Bank constitute "profits" within the meaning of the *Howey-Forman* test. A review of the Supreme Court's treatment of the expression "profits" convinces us they do not.[12]

In *Tcherepnin v. Knight, supra*, the Court held that nonnegotiable, withdrawable capital shares in a savings and loan association were securities within the meaning of section 3(a)(10) of the 1934 Act. The Court applied the *Howey* test, found its requirements satisfied and concluded that the shares had the "essential attributes of investment contracts" as that term was used in the Act and defined in *Howey*. A key "essential attribute" was the possibility of appreciation in the value of the investment. The holders of the withdrawable shares were not entitled to a fixed rate of return. Rather, they received dividends declared by the association's board and based on the association's profits. Prospective "profits" in the form of dividends were uncertain; they were a function of the profits of the association, which were in turn tied to the managerial skills of the business.

The focus on an expectation of appreciation in the value of an investment, or a variable rate of return, was reinforced by *Forman*. The plaintiffs in *Forman* sought the protection of the federal securities laws with respect to nontransferable, nonpledgeable "stock" in a nonprofit enterprise that they had purchased for the purpose of ensuring their right to rent certain low-cost apartments. The Court rejected the contention that the shares were "stock" as that term is used in the Acts, since the interests did not

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12. While profits in the form of a fixed rate of return are no less profits as envisioned by the literal understanding of the term, we agree with Judge Learned Hand that "it is one of surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary. . . ." *Cabell v. Markham*, 148 F.2d 737, 739 (2d Cir.), *aff'd* 326 U.S. 404 (1945).

include either the most common feature of stock: the right to receive dividends contingent upon an apportionment of profits, or other attributes such as voting rights and negotiability, 421 U.S. at 851. The Court then considered whether the interests were investment contracts, analyzing carefully the "profits" element of the *Howey* test. The Court held that this element of the test was not satisfied and consequently the interests involved were not investment contracts. The key characteristic lacking was the possibility of appreciation; the shares could not appreciate in value since they were subject to a buy back agreement whereby the housing cooperative could repurchase the shares at the tenant's original cost. The Court expanded on its concept of "profits":

> By profits, the Court has meant either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors' funds. . . . In such cases the investor is "attracted solely by the prospect of a return" on his investment. *Howey, supra*, at 300. By contract, when a purchaser is motivated by a desire to use or consume the item purchased . . . the securities laws do not apply. 421 U.S. at 852-53.

In the present case it is undisputed that the Bank had no expectation of capital appreciation; on the contrary, the return expected by the Bank was simply the repayment of the amounts advanced plus a fixed rate of interest. The rate of return the Bank could expect was fixed in the Participation Agreement at the prevailing prime rate plus two points. These interest payments were not contingent. Indeed, CCBL held back 15% of the loan amounts to insure payment. The adequacy of the interest fund was never disputed by the Bank during the life of the loan and the Bank received the full interest to which it was entitled prior

to Donald's collapse. Under the terms of the Participation Agreement, no higher rate of return was possible. The profit which would accrue to the Bank in the form of interest earnings was contingent only upon the passage of time, and was not of a different nature than in a commercial lending transaction. Accordingly, the Bank had no reasonable expectation of profit as that term is used in the *Howey-Forman* securities context.

PROFITS DERIVED FROM THE EFFORTS OF OTHERS

The final element of the *Howey-Ferman* test requires that the profits be derived from the "managerial or entrepreneurial efforts of others." In its brief the Bank argues that its "receipt of interest income was dependent entirely upon the success of CCBL's efforts to successfully manage Donald's financing and keep them in business." We reject the Bank's argument that the final phase of the test refers to the efforts of CCBL, the lead lender. Although CCBL was clearly responsible for performing certain administrative tasks, those services are not managerial or entrepreneurial within the meaning of the *Howey-Forman* test. The interest income which was to be paid to the Bank and CCBL was to be derived from the efforts of Donalds in retailing furniture. These efforts, in the long run, were unsuccessful and eventually resulted in bankruptcy, but they were not the efforts of CCBL and therefore the legal test of *Howey-Forman* has not been satisfied.

This result is consistent with the conclusion reached by the majority of federal courts which have considered the issue. For example, in *FBS Financial, supra,* where the court held that a loan subparticipation was not a security, the lead lender had sole responsibility for servicing and administering the loan on behalf of five loan participants.

The court noted that centering this responsibility in one lender was indigeneous to a loan participation, since efficient administration would be impossible if management were decentralized among all the participants. The necessary concentration of management services in the lead lender, however, did not render those services "entrepreneurial" as required by *Howey* and *Forman*. Admittedly, the lead lender was responsible for monitoring to completion the construction of an office building which would produce the interest income, but that interest income was not "derived from" the efforts of the lead lender whose managerial efforts were certainly not entrepreneurial. This analysis applies with equal force here. The responsibilities undertaken by CCBL were routine, loan monitoring tasks. Although CCBL supervised the loan, policed the collateral, and collected interest and principal payments, its efforts were not managerial or entrepreneurial in the sense that they generated the return expected by the parties.

In sum, the Bank's attempt to classify the loan participation as a security under the facts present here must fail. The securities laws are not a panacea for commercial loans gone awry. Relief from the consequences of commercial transactions unwisely contracted must be found in another haven. *See Amfac Mortgage Corp. v. Arizona Mall of Tempe*, 583 F.2d 426, 428 (9th Cir. 1978). The decision of the district court that the loan participation interest purchased by the Bank does not constitute a security is affirmed.

IV.

In addition to the federal securities claim, the Bank sought to recover for misrepresentations by CCBL which induced the execution of the amendment to the Participation

Agreement under the Tennessee common law of fraud.[13] In the second Special Verdict, the jury found CCBL guilty of commercial fraud under Tennessee law based upon a negligent misrepresentation concerning the credit-worthiness of Donald's accounts receivable in connection with the execution of the amendment to the Participation Agreement. The third Special Verdict answer, however, found the Bank guilty of contributory fault which proximately caused its injury.[14] Under Tennessee law, contributory negligence is a defense to claims of fraud based upon negligent misrepresentation. Accordingly, the trial judge entered judgment for CCBL on this issue.

In a post-trial motion to alter or amend the judgment on Tennessee common law fraud, the Bank argued that because a finding of intentional fraud was inherent in the jury's answer to Special Verdict No. 1, the contributory fault verdict was precluded even though Tennessee law differed from federal law by recognizing negligent fraud. The district judge denied that motion.

With a subtle but significant shift in analysis, the Bank now argues that the "trial court's refusal to enter judgment for the Bank on common law fraud was premised upon a refusal to acknowledge that Tennessee law recognizes two separate and different causes of action for fraud." The Bank asserts that the two types of fraud which must be distinguished are intentional fraud and negligent fraud. The latter is based on negligent misrepresentation,[15] while the former is predicated upon knowing

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13. The jurisdictional basis for these claims was diversity of citizenship, not pendent jurisdiction. *See Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1022 n.9 (6th Cir. 1979).

14. In ruling on the post-trial motions, Judge McRae reinforced this finding, characterizing the Bank's handling of the loan participation as "gross ineptness".

15. *See Guilbert v. Phillips Petroleum Co.*, 503 F.2d 587, 591 (6th Cir. 1974).

or reckless conduct, comparable to a federal securities law fraud claim pursuant to section 10b and Rule 10b-5.[16]

CCBL does not contest the existence of a Tennessee action for intentional fraud, but rather argues that the Bank never presented this claim at trial, never requested any jury instructions on this theory, and cannot through some sleight of hand interpolate the jury's findings on the federal count to a state count raised for the first time on appeal.

In its brief the Bank concedes that the jury's finding of contributory negligence bars recovery on the theory of negligent fraud, but argues that the jury's finding that CCBL knowingly or recklessly violated the federal securities acts requires recovery on intentional fraud as well. Thus, the Bank seeks to attach a collateral estoppel effect to the jury's finding of knowing or reckless conduct by CCBL in connection with the federal fraud claim; it seeks to use the factual findings of Special Verdict No. 1 to support a judgment for itself on common law intentional fraud. This is required, the Bank argues, because the elements of Tennessee intentional fraud are inherent in the federal sec. 10b/10b-5 claim,[17] allowing factual findings to

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16. *See Graham v. First American National Bank*, 594 S.W. 2d 723, 725 (Tenn. Ct. App. 1979).

17. In *Mansbach, supra*, we observed that "[t]he Sec. 10b/10b-5 claim is not identical to common law fraud, *see James v. Gerber Products Co.*, 483 F.2d 944, 946 (6th Cir. 1973) . . ." 598 F.2d at 1024. There are substantial similarities, however, between certain elements of the two actions. In *Mansbach* we delineated the elements of a federal securities fraud claim as 1) the use of jurisdictional means 2) to implement a deceptive or manipulative practice (with the requisite scienter) 3) in connection with 4) the purchase or sale 5) of a security 6) causing 7) damages. 598 F.2d at 1026.

In *Edwards v. Travelers Insurance of Hartford, Conn.*, 563 F.2d 105 (6th Cir. 1977), we capsulized the elements necessary to sustain an action for intentional fraud under Tennessee law: 1) a false representation 2) of an existing or past material fact 3) made knowingly or without belief in its truth or recklessly (with scienter) 4) which induces reasonable reliance 5) resulting in damages. 563 F.2d at 110-113.

be transposed from the federal count to the state count, so that the court can determine the appropriate judgment to be entered on the special verdict's answer.[18] To support its position, the Bank cites *Solomon v. United States*, 276 F.2d 669, 676 (6th Cir.), *cert. denied*, 364 U.S. 890 (1960). There the jury returned separate verdicts against four defendants in a conspiracy case. The defendants argued that separate verdicts were inconsistent with the law of conspiracy where liability is joint and several. This court rejected that contention, noting that under FRCP 49(a) the trial judge is authorized to submit special findings of fact to the jury which might be made under the pleadings and evidence. The jury's findings, in the form of special verdicts, the court went on, are merely factual findings to which the judge must then apply appropriate legal principles.[19] Therefore, the judge could enter verdicts for joint and several liability since the jury had found the facts necessary to convict each defendant.

With the wisdom of *Solomon*, the judge must apply appropriate legal principles to the factual findings returned by the jury, here reflected in the answers to the Special Verdicts. The district judge did just that in granting JNOV on the federal securities claim. Although the jury had returned the requisite factual findings to support a verdict for the Bank, only the trial judge could rule on the threshold legal issue, namely, the existence of a security. His ruling that the loan participation was not

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18. This position assumes, of course, that the district judge abused his discretion in ordering a new trial. In light of our conclusion that the Bank is prohibited from raising the claim of intentional fraud on appeal, we need not review the conditional grant of a new trial.

19. To be sure, special verdicts are concerned only with issues of fact, not issues of law. *See e.g. Dual Mfg. & Eng. v. Burris Industries*, 619 F.2d 660, 667 & n.6 (7th Cir.) (en banc), *cert. denied*, 101 S.Ct. 208 (1980).

a security thereby eclipsed the jury's answer to Special Verdict No. 1, requiring a judgment for the defendant.

Our review of the record convinces us that the trial judge did not enter judgment for the Bank on intentional fraud under Tennessee law because the Bank never asserted a claim based on this cause of action. Conspicuously absent from the Bank's complaint is any reference to intentional fraud under Tennessee law. Indeed, the only reference to any common law claim is the cryptic notation in the complaint that "The Court has jurisdiction of all other claims made herein pursuant to the principal of pendent jurisdiction and . . . the parties are of diverse citizenship." Regarding the defendant's misrepresentations and omissions, the only allegation is that such conduct constituted a Sec. 10b/10b-5 violation. All other assertions in the complaint concern CCBL's alleged negligence in the administration of the loan leading to the amendment of the participation agreement. Even a liberal reading of the complaint fails to hint at an assertion of a common law intentional fraud claim.

The district court's pre-trial order reflects this perception. That order characterized the Bank's contentions as two-fold: an allegation that CCBL's conduct made out a Sec. 10b/10b-5 violation, and an allegation that CCBL's conduct amounted to fraud under Tennessee common law, the elements of which were 1) untrue statements or omissions of facts; 2) reliance; 3) materiality. These are the elements of negligent fraud, not intentional fraud. That the district court's perceptions were accurate was confirmed by the Bank's special requests for jury instructions. The only requests regarding common law fraud, Nos. 25 and 26, concerned negligent misrepresentations. Accordingly, the jury did not receive a special verdict regarding intentional fraud.

Several factors convince us that the Bank's failure to raise intentional fraud at trial precludes it from raising that claim now. It is axiomatic that an issue not presented to the trial court cannot be raised for the first time on appeal. *Bannert v. American Can Co.*, 525 F.2d 104, 111 (6th Cir. 1975), *Schneider v. Electric Auto Light Co.*, 456 F.2d 366, 375 (6th Cir. 1972). *See also McMillan v. Marine Sulphur Shipping Corp.*, 607 F.2d 1034, 1038 & n.8 (2d Cir. 1979), *cert. denied*, 445 U.S. 905 (1980); *Johnson v. Holiday Inns, Inc.*, 595 F.2d 890, 894 (1st Cir. 1979).

This general rule is consistent with the finality accorded the pre-trial order. Pretrial orders are designed to expedite litigation and eliminate surprise by framing the issues remaining for trial. The Bank does not contend that the pretrial order here was improperly drawn, and we see no problems with it. Even under a liberal construction, that order does not embrace the theory now articulated by the Bank. Under Fed. Rule Civ. Pro. 16 the pre-trial order controls the subsequent course of the proceedings and becomes the governing pattern of the lawsuit. *Management Investors v. United Mine Workers*, 610 F.2d 384, 390 n.17 (6th Cir. 1979). Since the defendant had no meaningful opportunity to argue the issue in the district court, the judge appropriately chose not to rule on the issue of intentional fraud. *See Seymour v. Coughlin Co.*, 609 F.2d 346, 348 (9th Cir. 1979).

Finally, the Bank's failure to seek proper jury instructions based upon Tennessee Law, forecloses it from now raising the claim. When a state-created right is being asserted, the state law must be looked to for the substance of the instruction. *Lones v. Detroit, Toledo and Ironton Railroad Company*, 398 F.2d 914, 920 (6th Cir.), *cert. denied*, 393 U.S. 1063 (1968). Had the Bank argued fraudulent misrepresentation under Tennessee law at trial, CCBL

would have been entitled to certain jury instructions based upon Tennessee law.

CCBL argues that the waiver provision of Fed. R. Civ. Pro. 49(a) precludes our consideration of the Bank's claim. Under Rule 49(a), the failure of a party to request the court to submit any issue to the jury which the court might have overlooked is a waiver of that claim by the party. In the present case the Bank did not submit any special verdict questions relevant to the issue of common law intentional fraud. Rather, the instructions proffered by the Bank related solely to negligent fraud.

We find the waiver provision of dubious applicability here. The waiver provision of Rule 49(a) only applies, when, in submitting the issues to the jury, the court "omits any issue of fact raised by the pleadings or by the evidence." *See General Beverage Sales Co. v. East Side Winery*, 568 F.2d 1147, 1155 (7th Cir. 1978). Since the issue of common law intentional fraud was never raised by the pleadings or the evidence, it could not be omitted from the special verdicts submitted for the jury's consideration.

The decision of the district court is affirmed.

(Filed September 14, 1978)

C-75-76

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

UNION PLANTERS NATIONAL BANK OF MEMPHIS,
a National Banking Association,
Plaintiff,

vs.

COMMERCIAL CREDIT BUSINESS LOANS, INC.,
a Delaware Corporation,
Defendant.

RULING UPON POST-TRIAL MOTIONS

This ruling represents the Court's written ruling upon certain motions including the defendant's Motion for a Judgment Notwithstanding the Verdict or a New Trial.

The plaintiff filed this suit originally seeking recision of a contract with the defendant and for damages for violation of the laws of the United States and the State of Tennessee pertaining to the sale of securities. Early in the case the Court ruled that the recision complaint was inconsistent with retaining the continuing payments under the agreement between the plaintiff and the defendant.

The case was called for a severed jury trial in March 1978 with the plaintiff relying upon two theories of liability, namely, (1) that the defendant's conduct constituted a violation of Section 10(b) of the United States Securities Exchange Act of 1934 and Rule 10(b)(5) of the United

States Securities and Exchange Commission Regulations, and (2) that the defendant's conduct amounted to commercial fraud against the plaintiff under the common Law of Tennessee, which may be based upon negligence on the part of the fraudulent actor.

The Court submitted special issues to the jury to cover the respective theories of the plaintiff. For the cause of action based upon the claimed violation of the United States laws and regulations, the Court submitted and received the following verdict:

> 1. Did the defendant violate the United States laws and regulations pertaining to the sale of securities by making an untrue statement of a material fact or by omitting to state a necessary material fact concerning the credit worthiness of the accounts receivable to Donald Furniture Co., Inc. in connection with the negotiation for and the execution of Amendment No. 1 to Participation Agreement dated July 11, 1973?
>
> X (Yes) ____ (No)

On the cause of action barred upon the commercial fraud under the common law of Tennessee, the Court submitted two issues, one for a determination whether the jury found the defendant guilty of commercial fraud based upon negligent misrepresentations and, if so, whether the plaintiff was guilty of contributory fault which proximately caused the plaintiff's damages. On these issues the jury found that the defendant was guilty of negligent fraud and the plaintiff was guilty of contributory fault.

Therefore, the Court caused a judgment to be entered on March 27, 1978, in favor of the plaintiff upon the liability issue under the federal claim, and in favor of the defendant upon the claim based upon the common law

of Tennessee. The defendant filed a Motion for a Judgment Notwithstanding the Verdict or a New Trial, which was amended so that it ultimately relied upon 17 numbered grounds, many of which had multiple subparts. The plaintiff filed a Motion to Alter or Amend the Judgment on Special Jury Verdicts to the effect that the jury's finding on the federal issue was based upon intentional fraud, therefore the contributory fault verdict was precluded even though the Tennessee law differs from the federal law by recognizing negligent-fraud in commercial transactions. The post trial motions were briefed in addition to the voluminous briefs which had been filed preliminarily. In addition, the Court set the motions for arguments at an oral hearing. At the end of the hearing the Court announced its ruling that the Court had become persuaded that the agreement between the parties was not a security within the meaning of the laws and regulations of the United States, and therefore a judgment notwithstanding the verdict should be entered in favor of the defendant. The Court is also persuaded that, even if the Court is in error in that regard, justice requires a new trial on certain grounds.

In order to announce the Court's ruling, it is necessary that certain basic facts should be noted.

For a number of years prior to 1971, one of the valued customers of the plaintiff bank was Donald Furniture Company, Inc. Donald did its banking business with plaintiff as it enjoyed a growing success in the Memphis, Tennessee, market. In addition to the checking account business etc., the plaintiff lent Donald money on its accounts receivable.

On or about December 17, 1971, the defendant and plaintiff entered into a participation agreement whereby plaintiff bought a 50% participation in a $2,000,000 loan to Donald which was secured by the accounts receivable

under retail installment sales contracts of furniture of Donald's too rapidly expanding business. In the agreement between the parties the defendant was to administer and service the loan, and the plaintiff was to advance money as necessary up to the amount of the commitment of the plaintiff ($1,000,000). In the written participation agreement the plaintiff gave to the defendant practically unlimited discretion.

Soon after the execution of the December 1971 agreement the needs of Donald for additional funds became greatly increased and the defendant advanced considerably more funds to Donald, which ultimately reached approximately $7,500,000 as the defendant's sole share.

On July 11, 1973, the parties entered into a supplemental agreement for a 50% participation by the plaintiff in a $10,000,000 loan to Donald. This too was quickly consumed, again due to the too rapid expansion of the business of Donald.

The main reason for the commencement of the lawsuit occurred on September 26, 1974. On that date an involuntary bankruptcy proceeding was filed against Donald, and the affairs of Donald were administered thereafter pursuant to the laws pertaining to bankruptcy procedures. The accounts receivable of Donald which were the security for the loan made by the plaintiff and defendant are being collected by the defendant, and remittances are being made from time to time for the plaintiff's pro rata share. As heretofore indicated, the attorneys for the plaintiff at one time sought to rescind the agreements and keep the amounts being collected.

For the purposes of the litigation which was pending, the attorney for the plaintiff sought to prove the securities fraud because the breach of contract route was too difficult

inasmuch as the plaintiff had given the defendant full discretion in the administering of the loan. However, in the presentation of the proof of the plaintiff, counsel undertook to try the case as a breach of contract suit. They offered proof of the alleged representations of the officials of the defendant prior to the execution of the contract, which alleged representations were inconsistent with the terms of the contract, and they offered proof of the conduct of the defendant after the execution of the supplemental agreement, supposedly as evidence of intent of the defendant at the time of the execution of the supplemental agreement, July 1973.

Counsel for the plaintiff also offered proof of some internal disagreement in the hierarchy of the defendant with procedures being used by Donald prior to the July 1973 supplemental agreement which was shown by audits made at the direction and instance of defendant personnel. This proof was offered as material facts which defendant did not discolse, and therefore plaintiff presumptively relied on the alleged misrepresentation.

On the eve of the trial counsel for the plaintiff also obtained the services of certain so-called experts who applied hindsight findings to the procedures used by Donald, and therefore determined that the procedures were not customary and proper.

Counsel for the defendant has consistently contended that the agreement of July 1973 was not a security within the meaning of Section 10(b) of the Securities & Exchange Act of the United States of 1934 and Section 10(b)(5) of the regulations of the Securities & Exchange Commission. Due to the conflicting authorities, the Court reserved its ruling on this point until it had heard the evidence at the trial. During the trial the Court ruled that the supplemental participation agreement of July 1973 was a security

within the meaning of the federal laws. However, upon further consideration the Court is persuaded that the agreement between the parties was a joint venture in a commercial loan to Donald and not a security as defined by the laws of the United States and its regulations.

When the "economic realities" test of *United Housing Fdn. v. Forman*, 421 U.S. 837 (1975) is applied to the undisputed facts of this case, the Court is convinced that Congress did not intend for the participation agreement between these parties to be a security within the terms of Section 10(b) of the Act and 10(b) of the Regulations. See Defendant's Memorandum in Support of Its Motion for a Judgment Notwithstanding the Verdict of a New Trial filed in the cause March 31, 1973, pages 2-13, and Defendant's Supplemental Memorandum filed April 18, 1978.

As heretofore indicated, if the Court is in error in its conclusion that the contract between the parties was not a security, then the manner in which this case was tried included errors which require that a new trial be granted if justice is to be done.

In particular the Court has reference to the allowance of the testimony of the expert Leamon to the effect that "credit worthiness" was a standard which determined whether Section 10(b and Regulation 10(b)(5) had been violated, and the subsequent inclusion of "credit worthiness" in the wording of special issue number one. These were errors of the caliber which require a new trial in the light of the proof offered and the manner in which the case was prepared and tried.

Similarly the Court should not have allowed the bank official Irvine to testify regarding matters which took place after the negotiation and execution of the supplemental

agreement of July 11, 1973, as evidence of the wilfullness of the defendant on July 11, 1973.

There was considerable controversy over whether the Court should have instructed the jury to the effect that the plaintiff had a duty to exercise "due diligence" not to be defrauded. The Court determined that this should not be done, particularly since *Ernst and Ernst v. Hockfelder*, 425 U.S. 125 (1976) had ruled that negligence or lack of ordinary care could not form the basis of a private cause of action under Section 10(b) of the Securities and Exchange Act. This Court is not persuaded that it was in error in this regard. However, if the Court was in error in that regard, the Court is of the opinion that the gross ineptness of the bank official who handled this matter constituted lack of "due diligence" as a matter of law.

In summary, this Court rules that the judgment heretofore entered in favor of the plaintiff based upon the cause of action pertaining to the violation of the laws of the United States and the regulations pertaining to fraud in securities transactions is hereby vacated, and the Clerk is directed to enter a final judgment for the defendant on all causes of action for the reasons set forth herein. While the Court is overturning its former judgment on the federal issues, it is not altering, amending, or vacating its former judgment in favor of the defendant based upon the jury verdict pertaining to the issues based upon the cause of action sued upon under the common law of Tennessee.

ENTER: This 14th day of September 1978.

/s/ ROBERT M. MCRAE, JR.
Robert M. McRae, Jr., Judge
United States District Court

(Filed May 18, 1981)

No. 79-1191

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

UNION PLANTERS NATIONAL BANK OF MEMPHIS,
Plaintiff-Appellant,

vs.

COMMERCIAL CREDIT BUSINESS LOANS, INC.,
Defendant-Appellee.

Before: ENGEL and KEITH, Circuit Judges; CELEBREZZE, Senior Circuit Judge.

JUDGMENT

APPEAL from the United States District Court for the Western District of Tennessee.

THIS CAUSE came on to be heard on the record from the United States District Court for the Western District of Tennessee and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby affirmed.

It is further ordered that Defendant-Appellee recover from Plaintiff-Appellant the costs on appeal, as itemized below, and that execution therefor issue out of said District Court, if necessary.

ENTERED BY ORDER OF THE
COURT

/s/ John P. Hehman
Clerk

(Filed July 20, 1981)

CASE No. 79-1191

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

UNION PLANTERS NATIONAL BANK OF MEMPHIS,
Plaintiff-Appellant,

v.

COMMERCIAL CREDIT BUSINESS LOANS, INC.,
Defendant-Appellee.

ORDER

BEFORE: ENGEL & KEITH, Circuit Judges; CELEBREZZE, Senior Circuit Judge.

Plaintiff-appellant's petition for rehearing having come on to be considered, and it appearing that the petition for rehearing is without merit,

IT IS THEREFORE ORDERED that the petition for rehearing be and it hereby is denied.

ENTERED BY ORDER OF THE
COURT
John P. Hehman, Clerk
/s/ Bernard Green
Chief Deputy Clerk

Opposition

Office - Supreme Court, U.S.
FILED
NOV 19 1981
ALEXANDER L. STEVAS,
CLERK

No. 81-735

In the Supreme Court of the United States

October Term, 1981

UNION PLANTERS NATIONAL BANK OF MEMPHIS,
Petitioner,

vs.

COMMERCIAL CREDIT BUSINESS LOANS, INC.,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

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QUESTIONS PRESENTED

1. Is a participation by a bank in a loan made to one of the bank's regular, long-time customers by a finance company, which loan is secured by the accounts receivable of that customer and which participation bears interest at a fixed rate and grants the bank rights in the collateral in proportion to its share of the underlying loan to the customer, a "security" within the meaning of the Securities Exchange Act of 1934?

2. Where a jury was never instructed on the Tennessee common law of intentional fraud, no such instructions were requested, and the plaintiff failed to object to either the form of special questions submitted to the jury or the instructions, although the plaintiff did request and receive instructions on the Tennessee common law of negligent misrepresentations, did the trial court abuse its discretion by refusing to amend the judgment from one for the defendant on the Tennessee common law of negligent misrepresentation to one for the plaintiff pursuant to Tennessee common law intentional fraud based on the jury's findings to a special question submitted on the issue of federal securities law violations, which federal issue was, by judgment N.O.V., ruled inapplicable?

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MISCELLANEOUS

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No. 81-735

In the Supreme Court of the United States

October Term, 1981

UNION PLANTERS NATIONAL BANK OF MEMPHIS,
Petitioner,

vs.

COMMERCIAL CREDIT BUSINESS LOANS, INC.,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

Respondent, Commercial Credit Business Loans, Inc. ("CCBL"),[1] respectfully requests that the writ of certiorari for which Union Planters National Bank of Memphis ("Bank") has prayed be denied for the reasons stated herein. CCBL adopts the Bank's statements of the opinions of the courts below, jurisdiction, and statute involved; however, CCBL would include Rules 49, 51, and 59 of the Federal Rules of Civil Procedure, which are quoted verbatim in the Appendix hereto.

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1. Respondent's parent is Commercial Credit Company, all of the stock of which is owned by Control Data Corporation. Respondent has no non-wholly-owned subsidiaries. Respondent has approximately 300 affiliate corporations that are wholly-owned or principally owned by its parent, Commercial Credit Company.

STATEMENT OF THE CASE

In order to provide facts omitted by the Bank's petition crucial to the understanding of the decision below, CCBL will present its own statement of the case.

Donald Furniture Company ("DFC") was a successful furniture retailer based in Memphis, Tennessee (Tr. 6).[2] Since 1946, the Bank had been involved in lending to both DFC and its stockholders and considered this a very successful relationship (Tr. 6-8, 107-08). Mr. C. W. Irvine was the Bank officer in charge of the DFC account and loans to DFC (Tr. 52).

In 1970, the Bank's loan to DFC was secured by the accounts receivable generated by DFC from the sale of furniture to its customers. At that time, Irvine showed no interest in the details of the loan that the Bank now claims were crucial to its July 11, 1973 decision to purchase the loan participation involved in this case.[3]

On October 21, 1971, DFC contacted the Bank regarding the Bank's participation with CCBL in a loan to DFC. On November 26, 1971, DFC and CCBL executed the Revolving Loan Agreement (A136-41), which provided for continuing cash advances to DFC by CCBL, based on the value of, and against the collateral security of, all existing and future DFC accounts receivable (A136, ¶1), of which there were eventually some 17,000. On December 17, 1971,

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2. References are to the transcript (Tr.), the trial exhibits (Exh.), or the appendix (A) in the court below, or to the appendix (App.) in the Bank's petition.

3. Irvine received letters (often, six months late) from DFC informing him of the amount and value of DFC accounts receivable. The Bank did not take possession of the contracts. Irvine never went to a DFC store and had no knowledge of its bookkeeping systems or credit procedures. Irvine had no idea how DFC determined the value of the accounts receivable, which accounts receivable were considered delinquent, or if DFC made any type of determination of delinquencies (Tr. 107-12).

the Bank and CCBL executed the Participation Agreement (A10-13), which provided that the Bank would participate to the extent of fifty percent of the first two million dollars advanced to DFC, and conferred on the Bank rights in the accounts receivable proportionate to this fifty percent share of the loan (A10-13, ¶¶1, 3-5). CCBL took possession of the DFC accounts receivable and the Bank released its previous lien. The Participation Agreement gave the Bank access to all CCBL records with regard to the loan (A12, ¶6), which rights the Bank never exercised. The collateral security was defined as all DFC accounts receivable, of whatever kind (A136, ¶1; A16, ¶4). The value of the collateral, for purposes of the loan, was to be determined by CCBL (A136, ¶1). CCBL would administer the loan for both lenders (A10-13, ¶4-7). The determination of the value of the collateral and the administrative details of the loan were in the sole discretion of CCBL pursuant to Paragraph 7 of the Participation Agreement (hereinafter "Paragraph 7"). Paragraph 7 also contained a disclaimer by CCBL of any representations with respect to certain limited aspects of the loan.[4]

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4. The extent of this discretion over certain aspects of the loan and the collateral pool and the disclaimer in Paragraph 7 merits its full quotation:

> 7. Commercial Credit may in its sole discretion approve or decline to approve the credit risk on and acceptability of Collateral; take, release, substitute or refuse Collateral or other security; give or withhold waivers, consents, extensions, adjustments, compositions or compromises; amend or refuse to amend the Financing Agreement or other agreements relating thereto; exercise or refrain from exercising rights, or take or refrain from taking action with respect to Advances, Collateral, other security or with respect to the Financing Agreement, or in any other way in making, handling, collecting, realizing upon, or enforcing repayment of Advances or Collateral or other security or the Financing Agreement or guaranties, and, without limitation, Commercial Credit makes no representations and assumes no responsibility with respect to Collateral, the Financing Agreement or other papers relating thereto, or to their value, validity or enforceability, or the correctness of any papers, statements or certificates made by [DFC.]

By March, 1972, two million dollars had been advanced to DFC - one million dollars each by the Bank and CCBL (Exhs. 50, 51). CCBL, however, continued lending its *own* money to DFC, pursuant to the Revolving Loan Agreement, as it had the right to do. Between March, 1972 and April, 1973, CCBL advanced approximately another 5.5 million of its own funds to DFC,[5] without Bank participation.

In April, 1973, CCBL decided to increase the loan from $7,500,000 to $8,250,000 (Tr. 580). DFC anticipated a future need of a total of ten million dollars; therefore,

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5. Between March, 1972 and April, 1973, the Bank claims that CCBL learned through its August and December, 1972 audits unfavorable material facts which CCBL should have disclosed to the Bank. Of course, the actions of CCBL do not indicate that it believed the information it received was unfavorable, since CCBL continued to advance its own funds after these audits. No disclosure to the Bank of the information in those audits would have been material when those audits were received by CCBL, since the Bank could not have terminated its loan, although Irvine had misread the agreements that way (Tr. 135). *See* text at p. 6, *infra*.

Furthermore, the proof showed that many of the auditors' statements in those audits were wrong (Tr. 541-47). The only adverse facts in the August and December, 1972 audits were the auditors' negative opinions of accounting and bookkeeping "controls" of DFC (Tr. 541-49). There is no proof that these conditions had not always existed at DFC and Irvine admitted having no knowledge of DFC's bookkeeping procedures prior to the Participation Agreement (Tr. 107-08). The "control problems" were unrelated to the issue raised by the special jury question regarding "creditworthiness" of the collateral. The accounting controls were indicative of the sometimes sloppy business practices at DFC, the difficulty management had in its bookkeeping and record keeping and cash flow problems. These conditions were known or should have been known to the Bank by virtue of its close relationship with DFC (Irvine admitted knowing about the constant cash flow problems at DFC. DFC was overdrawn at the Bank constantly from the inception of the participation (Tr. 185-198; A464-73; Exh. 58-59), but the Bank always covered the DFC overdrafts).

Most importantly, the August and December, 1972 audits were not the existing material facts on July 11, 1973 since exclusively favorable information about DFC was available to CCBL on this date. *See* n.6, *infra*.

DFC approached the Bank to participate with CCBL to the extent of fifty percent in a line of credit of ten million dollars (A321-23). This was done to save DFC money since the Bank's interest rate on its portion of the loan was lower than that of CCBL (Tr. 620). On July 11, 1973, the Participation Agreement was amended to provide for a ten million dollar line of credit in which the Bank would participate to the extent of fifty percent.[6]

By October 22, 1973, the loan balance had reached ten million dollars. According to the Bank's theory, CCBL knew adverse material facts regarding DFC and the uncreditworthiness of its accounts receivable on July 11, 1973; however, between July 11, 1973 and October 22, 1973, CCBL loaned $800,000 of its own money to DFC (Exhs. 50, 51). Furthermore, after October 23, 1973, CCBL agreed to lend DFC an additional 2.5 million dollars (A350) without Bank participation, and actually loaned DFC, between November 9, 1973 and July, 1974, an additional 1.5 million dollars without Bank participation.

In 1974, the nation suffered a recession, resulting in high unemployment, thereby affecting the ability of DFC

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6. At this time, CCBL had available to it an April, 1973 audit in which the same auditor who helped author the previous audit commented on the progress of DFC in clearing up the problems commented on in August and December, 1972 (A311-20) and recommended continuing the loan (Tr. 533-39; A311-20). CCBL had also just performed a delinquency analysis in June, 1973 in which it was determined that the delinquency rate was no problem (Tr. 576-77). Similarly, a delinquency analysis done in October, 1972 after the August, 1972 audit revealed no delinquency or other problems were being caused by the "control" problems mentioned in that audit (Tr. 547). CCBL *and the Bank* also had in their possession a favorable financial statement by DFC accountants Haskins & Sells for the year ending December 31, 1972 (Tr. 96-97, 402; A507-18).

The Bank records are consistent with the favorable April 27, 1973 audit, the favorable December 31, 1972 financial statement and the June, 1973 delinquency analysis. These records show that the DFC overdraft problem disappeared from January, 1973 to July, 1973 (Tr. 197).

customers to pay their accounts (Tr. 197-98). Throughout early 1974, the business and cash flow of DFC suffered. In March, 1974, Irvine decided to leave CCBL holding the bag and requested that CCBL repurchase the Bank's share of the loan (A395-96; Tr. 71-72). Irvine's careful reading of the agreements had led him to believe that the Bank could demand this of CCBL at any time. Not until trial did Irvine admit that from the beginning of the original participation in December, 1971, he had erroneously believed that the Bank could require CCBL to repurchase the Bank's share of the loan on 30 days notice (Tr. 135-37), thereby giving the Bank a risk-free loan insofar as the ability of DFC to repay it was concerned.

In September, 1974, DFC was placed in bankruptcy. The Trustee abandoned the accounts receivable to CCBL, which began to collect them, remitting to the Bank fifty percent of collections for its share of the loan participation, although this was more than the Bank's share of the total loan to DFC after the further increases by CCBL.

The Bank filed suit in February, 1975. During a six-day jury trial, as the trial court noted,[7] the Bank attempted to prove fraud by showing that CCBL breached the Participation Agreement by not administering the loan to DFC properly or in accordance with the written agreements. The Bank offered an expert witness to review a sample of accounts receivable and render an opinion on the "creditworthiness" of these receivables.[8] In fact, the "problems" with the DFC accounts receivable upon which his opinion was based were all permitted by the contracts (or within

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7. App. 30, 34.

8. The trial court allowed the Bank, through a second expert witness (over objection by CCBL), to show by opinion which facts allegedly not disclosed to the Bank by CCBL were material to the Bank (A303-52).

the discretion of CCBL under Paragraph 7), and known (or should have been known with the exercise of the slightest amount of care or diligence) by the Bank.[9]

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9. The expert and the Bank claimed the following facts regarding the receivables rendered them uncreditworthy:

(a) *Change by DFC from "Installment" to "Revolving" Contracts.* The definition of "contracts" in the loan agreement between CCBL and DFC, which loan agreement was incorporated in the Participation Agreement, included revolving contracts (A136-40, ¶1; A16-21, ¶4). Furthermore, the definition could have been changed at any time by CCBL and the Bank had no right to be notified or object (A10-12, ¶4). Also, under Paragraph 7, CCBL could accept any type of collateral it wanted in its discretion.

(b) *Use of Particular Formula to Value DFC Accounts Receivable.* The Bank claimed that the nondisclosure of the use by CCBL of a particular formula to determine delinquent accounts was fraud. Irvine conceded that the determination of delinquency by formula was an exercise of the discretion granted CCBL by Paragraph 7 (Tr. 144-46). Moreover, there is nothing in the Participation Agreement or loan agreements requiring CCBL to employ any formula to calculate delinquencies, much less one approved by the Bank.

(c) *"Insufficient" Down Payments Made by DFC Customers.* None of the loan documents specified any minimum or suggested down payment. It was within the discretion of CCBL to take whatever collateral it deemed acceptable under Paragraph 7, notwithstanding the Bank's or the experts' opinion that collateral without a certain down payment was not creditworthy.

(d) *Inadequate Credit Applications of DFC Customers.* None of the loan agreements mentioned DFC credit applications and there was no proof that DFC credit applications had ever changed from when the Bank managed its receivables loan.

(e) *Advance Rate of 85 Percent Was Too High.* The 85-percent advance rate was provided in the November 26, 1971 Revolving Loan Agreement (A136-40, ¶1) and the July 11, 1973 Secured Term Loan Agreement (A16-21) and known by the Bank (Tr. 136-37).

(f) *Contract Terms of 48 Months With DFC Customers Were Too Long.* The Revolving Loan Agreement stated that DFC contracts would have terms of 48 months or less (A136-40, ¶4(e)).

(g) *Add-on Policy Regarding Additional Purchases of Furniture.* None of the loan agreements mentioned DFC add-on policy and there was no proof that it had ever changed from when the Bank managed its receivables loan.

Before the case went to the jury (Tr. 936-86), the trial court asked that counsel submit requests for special instructions and suggested forms for special questions. After the jury charge, the Court asked counsel if there were any additional requests or objections to the instructions as given (Tr. 1019-29).

The Bank submitted over 30 special requests for instructions (A80-113). None included any reference to Tennessee common law intentional fraud. The only two requests submitted by the Bank relative to Tennessee law dealt with the law of negligent misrepresentations in commercial transactions. The Bank did not submit a special question dealing with Tennessee common law intentional fraud or object to the lack of a charge on Tennessee common law intentional fraud. No instruction or special question was given on the elements of or defenses to Tennessee common law intentional fraud. No opportunity, therefore, was given to CCBL to express its opinions on the elements of Tennessee common law intentional fraud or the defenses thereto.

Upon the jury's responses to the three special questions, the trial court entered judgment for the Bank as to liability under its federal claim, and for CCBL as to Tennessee common law commercial fraud (A117-118). CCBL moved for judgment N.O.V. or a new trial. Pursuant to Rule 59(e), the Bank requested the trial court to modify the judgment entered for CCBL on the Tennessee common law of negligent misrepresentations so as to render a judgment for the Bank (A119-25). The Bank's position was that because a finding of intent was inherent in the jury's response to the question under the securities law, the Bank was entitled to a judgment under Tennessee common law intentional fraud.

The trial court set the federal judgment aside since the participation was not a "security." The court also granted a conditional new trial based on the impropriety of the "creditworthiness" issue submitted to the jury and the admissibility of testimony from the Bank's expert and Irvine. It also stated that it felt that "due diligence" was irrelevant to a Rule 10b-5 case, but if it was wrong, the Bank's lack of due diligence and gross ineptness would bar recovery. Finally, the trial court refused to enter judgment for Tennessee common law intentional fraud (App. 30-36).

The Court of Appeals affirmed on the ground that a loan participation is not a security, and on the ground that the cause of action urged by the Bank - Tennessee common law intentional fraud - was never sought at trial or urged in the trial court as evidenced by the absence of any request for special questions or instructions on this claim (App. 27).

A. REASONS FOR NOT GRANTING THE WRIT ON THE SECURITY ISSUE

1. The Decision Below Is In Accord With Decisions Of The Fifth And Seventh Circuits And Not In Conflict With Any Decision From Any Other Circuit.

In *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), this Court set forth the test to determine whether a particular financial instrument is a "security" under the Securities Act of 1933 and the Securities Exchange Act of 1934. Since that opinion, each of the three circuit courts that has decided the issue has held that loan participation agreements are not securities. *Union Planters National Bank of Memphis v. Commercial Credit Business Loans, Inc.*, 651 F.2d 1174 (6th Cir. 1981); *United*

American Bank of Nashville v. Gunter, 620 F.2d 1108 (5th Cir. 1980); *American Fletcher Mortgage Co. v. U. S. Steel Credit Corp.*, 635 F.2d 1247 (7th Cir. 1980), *cert. denied* (No. 80-1484), ... U.S. ..... (1981), 49 U.S.L.W. 3685 (April 14, 1981).

The Bank's petition attempts to construct a conflict between the three loan participation cases and cases from the Second and Third Circuits.

In one such case, *Exchange National Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126 (2nd Cir. 1976), the financial instrument involved did not resemble typical commercial lending or loan participation agreements in any meaningful way. The case involved subordinated debentures maturing at dates ranging from twelve to eighteen months, but contingent on six month's written notice. The form and substance of the debentures were intentionally designed so the debentures would be considered equity capital for purposes of NYSE rules. No collateral was taken by the lender.[10]

Likewise, no conflict exists between the loan participation cases of the Sixth, Seventh and Fifth Circuits and the Third Circuit decision in *Weaver v. Marine Bank*, 637 F.2d 157 (3rd Cir. 1980), *reh. denied* (1/26/81), amended (1/28/81), *cert. granted* (No. 80-1562), ... U.S. ..... (1981), 49 U.S.L.W. 3893 (June 1, 1981), holding that the trial court erred in granting summary judgment to defendants on the basis that a six-year bank certificate of de-

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10. The Second Circuit, by way of discussion, listed a variety of financial instruments which it felt were clearly not securities and stated that all notes should generally be held to constitute securities unless they bear a "strong family resemblance" to the listed examples. 544 F.2d at 1137-38. The rights and obligations created by loan participation agreements bear a much stronger family resemblance to the list provided by the Second Circuit than they do to the subordinated debentures in *Exchange National Bank of Chicago*.

posit could not be a security. Certificates of deposit are, of course, unsecured forms of bank deposits and are generally uniform in nature. Furthermore, they are the epitome of "passivity" with regard to the depositor and bear no similarity to the Participation Agreement. The Bank characterizes its participation in the DFC loan as "passive" for all too obvious reasons but its participation was anything but "passive" in light of its long and continuing banking and lending relationship with DFC and its rights under the agreements, including its interest in DFC accounts receivable as collateral. In any event, this Court has granted certiorari on the certificate of deposit issue, which has a much broader application because of the widespread use of these instruments by the general public.

2. No Special Or Important Reason Exists For The Supreme Court To Review The Decision Of The Sixth Circuit.

The Bank states that significant and recurring problems concerning the scope of federal jurisdiction over "common non-equity financing arrangements" mandate review, claiming that "rational business planning is hampered by uncertainty."

Loan participation agreements are executed by financial institutions possessing particular skill in assessing financial risks. Typically, they set out in great detail the rights and duties of the participants in a commercial loan to a borrower. Unlike the uniformity of a certificate of deposit, each loan participation agreement is different depending on its purpose, the needs of the parties, and the demands of the various participants and the borrower. It is unrealistic to assume (and there is no proof in the record) that the negotiation or performance of these contracts to make joint loans and spread the lenders' risks is ham-

pered by anyone's concern that the fraud provisions of the securities acts are applicable to such agreements.

The Bank is also concerned about the uncertainty facing courts with the state of the law; however, the vast majority of courts (in addition to the three circuit courts that have decided the issue) have not had any problem finding that a loan participation is not a security.[11]

It would seem appropriate that this Court adhere to its past practice of granting certiorari on the security issue as it applies to relatively uniform instruments widely available and disseminated to the investing public[12] rather than one such as loan participation agreements which differ from transaction to transaction as a result of their negotiation by a relatively few sophisticated investors.

Since no conflict exists among the circuits with regard to the security issue (certiorari having recently been denied by this Court on this issue), and no special or important reasons exist otherwise for reviewing the Sixth Circuit's decision, petitioner's writ of certiorari should be denied.

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11. *Robbins v. First Am. Bank of Virginia*, 514 F.Supp. 1183 (N.D. Ill. 1981); *Manchester Bank v. Connecticut Bank and Trust Co.*, 497 F.Supp. 1304 (D. N.H. 1980); *Home Sav. and Loan Assoc. v. Isaac and Assoc.*, [1980 Transfer Binder] FED.SEC.L.REP. (CCH) ¶97,811 (N.D. Ill. 1980); *Provident Nat'l Bank v. Frankford Trust Co.*, 468 F.Supp. 448 (E.D. Pa. 1979); *FBS Financial, Inc. v. Clevetrust Realty Investors*, [1977-1978 Transfer Binder] FED.SEC.L. REP. (CCH) ¶96,341 (N.D. Ohio 1977); *but see, Commercial Discount Corp. v. Lincoln First Commercial Corp.*, 445 F.Supp. 1263 (S.D. N.Y. 1978); *NBI Mortgage Inv. Corp. v. Chemical Bank*, [1976-1977 Transfer Binder] FED.SEC.L.REP. (CCH) ¶95,632 (S.D. N.Y. 1976) and [1977-1978 Transfer Binder] FED.SEC.L. REP. ¶96,066 (S.D. N.Y. 1977) (participation agreement *may* be a security, depending on the facts of the case).

12. *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551 (1979) (noncontributory pension plan); *Weaver v. Marine Bank*, *supra* (bank certificate of deposit).

B. REASONS FOR NOT GRANTING THE WRIT ON THE AMENDMENT OF JUDGMENT ISSUE

1. The Decision Below Is Not In Conflict With Decisions From Other Circuits Or Against The Weight Of Other Judicial Authority.

The Bank's artful rendition of the second question presented for review disingenuously omits any reference to the Bank's failure to request instructions or special verdict forms or questions regarding its post-trial theory of Tennessee common law intentional fraud. Similarly, it fails to mention that, when given the opportunity by the trial court after the jury charge, the Bank did not object to the instructions or special verdicts on the basis of the omission of this claim.

These crucial and rather glaring failures to adhere to Rules 49 and 51 of the Federal Rules of Civil Procedure prevent the Bank from reconstructing a judgment on a state cause of action never charged to the jury (which CCBL was never given the opportunity to defend or argue) based on facts theoretically found by the jury on an inapplicable federal cause of action, which is admittedly similar to the omitted state cause of action, but differs in some very meaningful ways as the facts of the case developed at trial.

These failures also distinguish the decision below from the case the Bank cites as creating a conflict between the circuits on this issue - *Life Insurance Co. of Virginia v. Murray Investment Co.*, 646 F.2d 224 (5th Cir. 1981), *reh. granted in part*, 651 F.2d 1090 (5th Cir. 1981), *cert. pending* (No. 81-798). In that case, the jury was apparently properly charged on the elements of both the Texas statute later found inapplicable (but pursuant to which the jury made its factual findings) and the Texas law

to which these facts were applied to support the punitive damage remedy. The defendants, therefore, at all appropriate times, had the opportunity to raise whatever objections to the instructions or special verdict forms or make any arguments to the jury they felt were appropriate.

Furthermore, the special factual interrogatories given to the jury in *Life Insurance Co. of Virginia* were in conjunction with Rule 49(b) and were highly detailed and specific with respect to each element of the charged causes of action.[13] In the decision below, the special verdict forms were submitted pursuant to Rule 49(a) and requested general verdicts concerning the two causes of action on which the jury was instructed without specific findings on each element of the causes of action. If deriving judgments or awarding remedies[14] on causes of actions not charged to juries by "transporting" facts impliedly or expressly found by juries on different, but charged, causes of action is proper at all, it is certainly more administratively practical from a trial judge's perspective if the factual findings are very specific.

Moreover, even the Fifth Circuit would prohibit a post-trial change of theory if such change prejudiced the opposing party. *International Harvester Credit Corp. v. East Coast Truck*, 547 F.2d 888 (5th Cir. 1977).

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13. *See* Petition for Writ of Certiorari at 7 and 20a-26a, *Life Insurance Co. of Virginia v. Murray Investment Co.* (No. 81-798).

14. It is noteworthy that the decision below involved the refusal to enter a judgment based on facts supposedly found on an inapplicable cause of action but the Fifth Circuit ruled on the award of a particular remedy - punitive damages - which was admittedly available under the applicable cause of action. The Bank's failure to request the punitive damage remedy, unavailable under both federal law and state negligent fraud law, is further evidence it never sought recovery under the Tennessee common law of intentional fraud, under which punitive damages are allowable. *Hutchison v. Pyburn*, 567 S.W.2d 762 (Tenn.Ct.App. 1977).

In factual circumstances more analogous to the decision below, other courts have consistently adhered to the policies underlying Rules 49 and 51. A condition precedent to a motion to alter a judgment based on an incorrect or omitted charge is a timely objection pursuant to Rule 51. *Arkla Exploration Co. v. Boren*, 411 F.2d 879 (8th Cir. 1969). In *Missouri Pacific Railroad Company v. Star City Gravel Co.*, 592 F.2d 455 (8th Cir. 1979), the plaintiff failed to request any jury instructions or special interrogatories on its theory of indemnity (which had been pleaded in the complaint) and did not otherwise alert the trial court to the need for jury instructions on that theory. The case went to the jury on the theory of contribution. The Eighth Circuit held it would be improper for the trial court to consider the jury's findings on the contribution issue and apply them to the indemnity issue since that issue was different and plaintiff failed to comply with Rule 51. *See also GBS Meat Industry Pty. Ltd. v. Kress-Dobkin Co.*, 474 F.Supp. 1357 (W.D. Pa. 1979).

The Bank's request for a "cut and paste" judgment extracted by guesswork from the jury's general responses to the special questions is an attempt to circumvent the requirements of Rules 49 and 51. Such grafting of "facts" to uncharged law would violate CCBL's right to trial by jury and its right to argue the merits of the state cause of action and defenses thereto before the jury. The decision below properly recognizes these facts and is in accord with the law. Therefore, the writ should be denied.

2. No Special Or Important Reason Exists For the Supreme Court To Review The Decision Of The Sixth Circuit.

The determinative and underlying issue presented by this question is one narrowly limited to the peculiar facts

of this case and not of general importance or precedential value to federal courts.

In *Life Insurance Co. of Virginia*, the elements of the legally inapplicable but charged cause of action (and the burden of proof thereon), were the same as the charged cause of action. Therefore, the findings could serve as the underlying factual predicate for the punitive damage remedy.[15] CCBL submits that this is not the case in the decision below (as the Sixth Circuit recognized), since the federal fraud cause of action under Rule 10b-5 differs from Tennessee common law intentional fraud (App. 25, n.17).

First, unlike federal law, Tennessee recognizes a duty to disclose only if there is some special or confidential relationship between the parties.[16] Second, Tennessee common law fraud recognizes the defense of due diligence (or justifiable reliance),[17] which the trial court refused to charge to the jury on the federal claim. Third, under Tennessee law, the plaintiff has the burden of proving *all* elements of his claim, unlike federal law, in which reliance is presumed in a nondisclosure case and defendant has the burden of overcoming the presumption.[18]

The trial court's instructions on Tennessee common law intentional fraud would have embodied these differences and under the facts in this case, the jury's factual findings on the elements of the state cause of action may

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15. 646 F.2d at 228-29.

16. *Domestic Sewing Machine Co. v. Jackson*, 83 Tenn. 418 (1885); *Dozier v. Hawthorne Dev. Co.*, 37 Tenn.App. 279, 262 S.W.2d 705 (1953).

17. *Kilgore v. Hix*, 205 Tenn. 564, 327 S.W.2d 474 (1959); *Simmons v. Evans*, 185 Tenn. 282, 206 S.W.2d 295 (1947); *Gilbert v. Hunnewell*, 59 Tenn. 289 (1873); *see Edwards v. Travelers Insurance of Hartford, Conn.*, 563 F.2d 105 (6th Cir. 1977).

18. *Chelsea Assoc. v. Rapanos*, 527 F.2d 1266 (6th Cir. 1975).

have been different. At a minimum, CCBL deserved the opportunity to object to any instruction given to the jury on Tennessee common law intentional fraud[19] and argue the case to the jury pointing out these differences.[20]

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19. When CCBL was given the opportunity to object to the instructions on Tennessee negligent fraud, it persuaded the judge that a third special question and instructions were mandated by the Tennessee case law (A944-54).

20. As the case developed, the differences between the state and federal law were not inconsequential.

CCBL consistently argued that a finding of reliance was impossible as a matter of law based on the following proof: (1) the disclaimer of all representations in Paragraph 7. *See NBI Mortgage Investment Corp. v. Chemical Bank*, [1977-1978 Transfer Binder] FED.SEC.L.REP. (CCH) ¶96,066 (S.D. N.Y. 1977) (defendant's motion for summary judgment granted on basis that disclaimer clause bars plaintiff's reliance); (2) the Bank could not rely on representations and omissions by CCBL with respect to matters the Bank committed to the sole discretion of CCBL under Paragraph 7; (3) the Bank did not rely on representations or omissions regarding aspects of the loan which it had not cared about when it was managing the loan, *see* n.3, *supra*, or which were specifically spelled out in the agreements, *see* n.9, *supra*, and (4) the Bank did not rely on any aspect of the nature of the loan, the colllateral, or its value as shown by Irvine's incorrect belief that he could get all of the Bank's money back from CCBL by giving 30 days written notice to CCBL. *See* n.5, *supra*. Therefore, the solvency of DFC and the "uncreditworthiness" of the collateral were irrelevant - only the solvency of CCBL would have affected the Bank's risk.

If the case had been submitted to the jury under Tennessee common law intentional fraud, CCBL would have been entitled to a charge that reliance on undisclosed facts must be proved by the Bank, not that reliance is presumed unless CCBL could prove otherwise, as was charged to the jury (A1008-09).

CCBL also urged the court to instruct the jury that if the Bank failed to exercise that amount of care and diligence commensurate with its financial knowledge and sophistication, it would be barred from recovery (due diligence defense). *See* n.17, *supra*. The court refused, but held that if it was wrong, it was finding as a matter of law that the Bank did not exercise due diligence (App. 30, 36).

Obviously, as evidenced by the trial court's post-verdict ruling and the jury's response to Special Verdict No. 3 finding contributory negligence on the Bank's part, a due diligence instruction may have made a difference on any issue submitted under the theory of Tennessee common law intentional fraud.

Granting certiorari in this case (or in *Life Insurance Co. of Virginia*), therefore, would compel this Court to decide whether the elements and burden of proof of the charged and uncharged causes of action were identical for the purposes of grafting the facts found from instructions to the former to the law of the latter. Whether Tennessee common law intentional fraud and fraud under Rule 10b-5 are so identical is hardly an issue worthy of review by this Court or one of general applicability or any precedential value.

There are other reasons why the amendment of judgment issue is not appropriate for review and was decided correctly below.

Amendment of judgment is typically discretionary with the trial court under Rule 59. The rule of law sought by the Bank would only confuse courts with respect to litigants' duties under Rules 49 and 51 and the trial court's discretion under Rule 59. It would encourage trial tactics by which litigants could hope to obtain factual findings (or implications) from a jury under a set of instructions on one theory, and thereafter request a trial judge in his discretion to render a judgment on another theory not having given the opposing side appropriate opportunity to raise objections to either the form of the issues going to the jury or the instructions under which such issues went to the jury.

The Bank has never stated why it failed to request instructions or special verdicts on Tennessee common law intentional fraud or why it failed to object to the instructions as given. It is not unlikely, however, that the Bank made a conscious choice to avoid the charging of a cause of action that would point out specifically to the jury the Bank's duty of due diligence and the differences in the burden of proof of reliance under Tennessee law. What-

ever the reason, it would be inappropriate for this Court to review an issue so confined to a peculiar factual situation which was created by the party seeking review by conscious trial strategy or a failure to comply with Rules 49 and 51 of the Federal Rules of Civil Procedure.

Since there is no conflict between the decision below and those of other circuits, and the underlying issue is not one of special importance or concern to federal courts or litigants, the Court should deny the petition of certiorari to review the judgment.

CONCLUSION

For these reasons, the writ of certiorari sought by the petitioner should be denied.

Respectfully submitted,

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APPENDIX

Rule 49. Special Verdicts and Interrogatories.

(a) SPECIAL VERDICTS. The court may require a jury to return only a special verdict in the form of a special written finding upon each issue of fact. In that event the court may submit to the jury written questions susceptible of categorical or other brief answer or may submit written forms of the several special findings which might properly be made under the pleadings and evidence; or it may use such other method of submitting the issues and requiring the written findings thereon as it deems most appropriate. The court shall give to the jury such explanation and instruction concerning the matter thus submitted as may be necessary to enable the jury to make its findings upon each issue. If in so doing the court omits any issue of fact raised by the pleadings or by the evidence, each party waives his right to a trial by jury of the issue so omitted unless before the jury retires he demands its submission to the jury. As to an issue omitted without such demand the court may make a finding; or, if it fails to do so, it shall be deemed to have made a finding in accord with the judgment on the special verdict.

(b) GENERAL VERDICT ACCOMPANIED BY ANSWER TO INTERROGATORIES. The court may submit to the jury, together with appropriate forms for a general verdict, written interrogatories upon one or more issues of fact the decision of which is necessary to a verdict. The court shall give such explanation or instruction as may be necessary to enable the jury both to make answers to the interrogatories and to render a general verdict, and the court shall direct the jury both to make written answers and to render a general verdict. When the general verdict and the an-

swers are harmonious, the appropriate judgment upon the verdict and answers shall be entered pursuant to Rule 58. When the answers are consistent with each other but one or more is inconsistent with the general verdict, judgment may be entered pursuant to Rule 58 in accordance with the answers, notwithstanding the general verdict, or the court may return the jury for further consideration of its answers and verdict or may order a new trial. When the answers are inconsistent with each other and one or more is likewise inconsistent with the general verdict, judgment shall not be entered, but the court shall return the jury for further consideration of its answers and verdict or shall order a new trial.

Rule 51. Instructions to Jury: Objection. At the close of the evidence or at such earlier time during the trial as the court reasonably directs, any party may file written requests that the court instruct the jury on the law as set forth in the requests. The court shall inform counsel of its proposed action upon the requests prior to their arguments to the jury, but the court shall instruct the jury after the arguments are completed. No party may assign as error the giving or the failure to give an instruction unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection. Opportunity shall be given to make the objection out of the hearing of the jury.

Rule 59. New Trials; Amendment of Judgments.

(a) GROUNDS. A new trial may be granted to all or any of the parties and on all or part of the issues (1) in an action in which there has been a trial by jury, for any of the reasons for which new trials have heretofore been

granted in actions at law in the courts of the United States; and

(2) in an action tried without a jury, for any of the reasons for which rehearings have heretofore been granted in suits in equity in the courts of the United States. On a motion for a new trial in an action tried without a jury, the court may open the judgment if one has been entered, take additional testimony, amend findings of fact and conclusions of law or make new findings and conclusions, and direct the entry of a new judgment.

(b) TIME FOR MOTION. A motion for a new trial shall be served not later than 10 days after the entry of the judgment.

(c) TIME FOR SERVING AFFIDAVITS. When a motion for new trial is based upon affidavits they shall be served with the motion. The opposing party has 10 days after such service within which to serve opposing affidavits, which period may be extended for an additional period not exceeding 20 days either by the court for good cause shown or by the parties by written stipulation. The court may permit reply affidavits.

(d) ON INITIATIVE OF COURT. Not later than 10 days after entry of judgment the court of its own initiative may order a new trial for any reason for which it might have granted a new trial on motion of a party. After giving the parties notice and an opportunity to be heard on the matter, the court may grant a motion for a new trial, timely served, for a reason not stated in the motion. In either case, the court shall specify in the order the grounds therefor.

(e) MOTION TO ALTER OR AMEND A JUDGMENT. A motion to alter or amend the judgment shall be served not later than 10 days after entry of the judgment.